S. HRG. 99-766

BUSINESS ACCOUNTING AND FOREIGN TRADE SIMPLIFICATION ACT

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY

AND THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 430

TO AMEND AND CLARIFY THE FOREIGN CORRUPT PRACTICES ACT OF 1977

JUNE 10, 1986

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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BUSINESS ACCOUNTING AND FOREIGN TRADE SIMPLIFICATION ACT

TUESDAY, JUNE 10, 1986

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY AND SUBCOMMITTEE ON SECURITIES,

Washington, DC.

The subcommittees met jointly at 10 a.m., in room SD–538, Dirksen Senate Office Building, Senator John Heinz (chairman of the Subcommittee on International Finance and Monetary Policy) presiding.

Present: Senators Heinz, D'Amato, Gorton, Mattingly, Hecht, Proxmire, Dixon, and Sasser.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. The hearing will come to order.

This hearing of the International Finance and Monetary Policy Subcommittee and the Securities Subcommittee is on the subject of S. 430, the Business Accounting and Foreign Trade Simplification Act. And as I contemplate this legislation, it is with a distinct sense of deja vu that the members of our two subcommittees turn their attention once again to the problems of the Foreign Corrupt Practices Act [FCPA].

Complaints from the American business community about the vague and confusing definitions and enforcement provisions in the FCPA have continued unabated since the FCPA became law in 1977. Billions of dollars of sales have been lost and continue to be lost because American businessmen have been convinced by their own Government that they should not aggressively pursue sales opportunities abroad. I don't think we can allow this condition to continue if the United States is to reduce its record trade deficits.

The recognition of these problems within the U.S. Government is not new. Both the Carter and Reagan administrations have supported changes in the Foreign Corrupt Practices Act. But despite the reporting of legislation by the Banking Committee with bipartisan support in both 1981 and then again in 1983 and Senate passage in 1981, the Congress has never succeeded in fixing the problems with the FCPA.

Today we are going to hear testimony on S. 430, a bill that I introduced along with Senators D'Amato, Chafee, and Garn and which is identical to the bill reported out of the Banking Commit-

tee in 1981 and 1983. I would like to very briefly review a few of the major improvements that S. 430 would make to the FCPA.

I believe the most important change is to clarify the bribery provisions to make them enforceable and to provide clear standards of conduct for American businessmen. The original act recognized that so-called facilitating payments were a necessary and acceptable part of doing business in many countries, but left vague what they were and who could receive them. S. 430 focuses on the intent of the payment, and clearly defines what are acceptable payments.

Equally important is S. 430's clarification of the use of agents. Under current law, companies are liable if they "know or have reason to know" that a bribe may be paid by a third party acting as agent. This has been the greatest concern of businessmen, especially small businessmen who must operate abroad through agents. S. 430 replaces this approach with language that makes U.S. companies liable if they corruptly pay a bribe directly or direct or authorize a bribe expressly or through a course of conduct.

S. 430 also eliminates the waste and confusion of dual enforcement of the bribery provisions by consolidating bribery enforcement in the Department of Justice. Any company with a question about the bribery provisions can get the answers in one place. The Securities and Exchange Commission would retain reponsibility for civil enforcement of the accounting standards provisions.

Finally, the bill would resolve problems with the accounting provisions, especially removal of criminal penalties for accounting infractions. While penalties would remain for poor accounting, criminal prosecution would focus on whether you had paid a bribe, not whether your papers were in order.

I know that there is broad support for the bill on the committee and within the administration and I'm delighted to have Secretary Baldrige testifying before the subcommittee today, and I applaud him being here with us to make the administration's case. I look forward to mounting once more a bipartisan effort to correct the problems of the FCPA so that what has been a significant impediment to aggressive American export effort can be removed.

[A copy of the proposed bill S. 430 follows:]

II

99TH CONGRESS
1ST SESSION

S. 430

To amend and clarify the Foreign Corrupt Practices Act of 1977.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 7 (legislative day, JANUARY 21), 1985

Mr. HEINZ (for himself, Mr. CHAFEE, Mr. GARN, and Mr. D'AMATO) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend and clarify the Foreign Corrupt Practices Act of 1977.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Business Accounting and Foreign Trade Simplification Act".

FINDINGS AND CONCLUSIONS

SEC. 2. (a) The Congress finds that—

(1) the enactment of the Foreign Corrupt Practices Act of 1977 was a positive and significant step toward the important objective of prohibiting bribery of

foreign government officials by United States companies in order to obtain, retain, or direct business;

(2) the Foreign Corrupt Practices Act of 1977 has caused unnecessary concern among existing and potential exporters as to the scope of legitimate overseas business activities;

(3) the accounting standards requirements of the Foreign Corrupt Practices Act of 1977, which apply to all issuers of securities irrespective of whether they have foreign operations, are unclear and excessive and have caused costly and unnecessary paperwork burdens;

(4) United States agencies responsible for enforcement of the Foreign Corrupt Practices Act of 1977 have not sufficiently coordinated interpretation and enforcement practices with other agencies responsible for international trade policy, export promotion, foreign policy, international monetary policy, and other related civil and criminal statutes; and

(5) it is in the best interests of all countries to maintain responsible standards of corporate conduct in foreign markets to preserve free and equitable trading practices.

(b) The Congress concludes that—

(1) the principal objectives of the Foreign Corrupt Practices Act of 1977 are desirable, beneficial, and important to our Nation as well as to our relationships with our trading partners, and these objectives should remain the central intent of the Act;

(2) exporters should not be subject to unclear, conflicting, and potentially damaging demands by diverse United States agencies responsible for enforcement of the Foreign Corrupt Practices Act of 1977;

(3) general compliance and enforcement practices associated with the Foreign Corrupt Practices Act of 1977 should be developed in accordance with considerations underlying foreign relations, international trade, export promotion, international monetary policy, and other related civil and criminal statutes; and

(4) a solution to the problem of corrupt payments by firms to obtain or retain business demands and international approach; accordingly, appropriate international agreements should be initiated and sought by the United States agencies responsible for trade agreements and by the President.

AMENDMENT OF SHORT TITLE

SEC. 3. Section 101 of the Foreign Corrupt Practices Act of 1977 is amended to read as follows:

"SHORT TITLE

"SEC. 101. This title may be cited as the 'Business Practices and Records Act'.".

ACCOUNTING STANDARDS

SEC. 4. (a) Section 13(b)(2) of the Securities Exchange Act of 1934 is amended to read as follows:

"(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—

"(A) transactions are executed in accordance with management's general or specific authorization;

"(B) transactions are recorded as necessary (i) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (ii) to maintain accountability for assets;

"(C) access to assets is permitted only in accordance with management's general or specific authorization;

"(D) the recorded accountability for assets is compared with the existing assets at reasonable intervals

and appropriate action is taken with respect to any differences; and

"(E) for the purposes of subparagraphs (A) through (D) of this paragraph, the issuer makes and keeps books, accounting records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.".

(b) Section 13(b) of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following:

"(4) No criminal liability shall be imposed for failing to comply with the requirements of paragraph (2) of this subsection.

"(5) No civil injunctive relief shall be imposed with respect to—

"(A) any issuer for failing to comply with the requirements of paragraph (2) of this subsection if such issuer shall show that it acted in good faith in attempting to comply with such requirements; or

"(B) any person other than an issuer, in connection with an issuer's failure to comply with paragraph (2), unless such person knowingly caused the issuer to fail to devise or maintain a system of internal accounting controls that complies with paragraph (2).

"(6) No person shall knowingly circumvent a system of internal accounting controls established pursuant to paragraph (2) for a purpose inconsistent with paragraph (2).

"(7) Where an issuer which has a class of securities registered pursuant to section 12 of this title or an issuer which is required to file reports pursuant to section 15(d) of this title holds 50 per centum or less of the voting power with respect to a domestic or foreign firm, the provisions of paragraph (2) require only that the issuer proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, including the relative degree of its ownership over the domestic or foreign firm and under the laws and practices governing the business operations of the country in which such firm is located, to cause such domestic or foreign firm to devise and maintain a system of internal accounting controls consistent with paragraph (2). Such an issuer shall be conclusively presumed to have complied with the provisions of paragraph (2) by demonstrating good faith efforts to use such influence.".

REPEALER; NEW BRIBERY PROVISION

SEC. 5. (a)(1) Section 30A of the Securities Exchange Act of 1934 is repealed.

(2) Section 32 of such Act is amended—

(A) by striking out "(other than section 30A)" in subsection (a); and

(B) by striking out subsection (c).

(b) Section 104 of the Business Practices and Records Act is amended to read as follows:

"FOREIGN PAYMENTS

"SEC. 104. (a) It shall be unlawful for any domestic concern, or any officer, director, employee, or shareholder thereof acting on behalf of such domestic concern, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of a payment, gift, offer, or promise, directly or indirectly, of anything of value to any foreign official for the purpose of—

"(1) influencing any act or decision of such foreign official in his official capacity, or inducing such foreign official to do or omit to do any act in violation of his legal duty as a foreign official; or

"(2) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality;

in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person.

"(b) It shall be unlawful for any domestic concern, or any officer, director or employee, or shareholder thereof acting on behalf of such domestic concern to make use of the

mails or any means or instrumentality of interstate commerce corruptly to direct or authorize, expressly or by a course of conduct, a third party in furtherance of a payment, gift, offer, or promise of anything of value to a foreign official for any of the purposes set forth in subsection (a).

"(c) Subsections (a) and (b) shall not apply to—

"(1) any facilitating or expediting payment to a foreign official the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official;

"(2) any payment, gift, offer, or promise of anything of value to a foreign official which is lawful under the law and regulations of the foreign official's country;

"(3) any payment, gift, offer, or promise of anything of value which constitutes a courtesy, a token of regard or esteem, or in return for hospitality;

"(4) any expenditures, including travel and lodging expenses, associated with the selling or purchasing of goods or services or with the demonstration or explanation of products; or

"(5) any ordinary expenditures, including travel and lodging expenses, associated with the performance of a contract with a foreign government or agency thereof.

"(d)(1)(A) Except as provided in subparagraph (B), any domestic concern which violates subsection (a) or (b) shall, upon conviction, be fined not more than $1,000,000.

"(B) Any individual who is a domestic concern and who willfully violates subsection (a) or (b) shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

"(2) Any officer or director of a domestic concern, or stockholder acting on behalf of such domestic concern, who willfully violates subsection (a) or (b) shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

"(3) Whenever a domestic concern is found to have violated subsection (a) or (b) of this section, any employee of such domestic concern who is a United States citizen, national, or resident or is otherwise subject to the jurisdiction of the United States (other than an officer, director, or stockholder acting on behalf of such domestic concern), and who willfully carried out the act or practice constituting such violation shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

"(4) Whenever a fine is imposed under paragraph (2) or (3) of this subsection upon any officer, director, employee, or stockholder of a domestic concern, such fine shall not be paid, directly or indirectly, by such domestic concern.

"(e)(1) When it appears to the Attorney General that any domestic concern, or officer, director, employee, or stockholder thereof, is engaged, or is about to engage, in any act or practice constituting a violation of subsection (a) or (b) of this section, the Attorney General may, in his discretion, bring a civil action in an appropriate district court of the United States to enjoin such act or practice, and upon a proper showing, a permanent or temporary injunction or a temporary restraining order shall be granted without bond.

"(2) For the purpose of all civil investigations which, in the opinion of the Attorney General, are necessary and proper for the enforcement of this Act, the Attorney General or any attorney or attorneys of the Department of Justice designated by him are empowered to administer oaths and affirmations, subpena witnesses, take evidence, and require the production of any books, papers, or other documents which the Attorney General deems relevant or material to the inquiry. Such attendance of witnesses and the production of such documentary evidence may be required from any place in the United States, or any territory, possession, or commonwealth of the United States, at any designated place of hearing.

"(3) In case of contumacy by, or refusal to obey a subpena issued to, any person, the Attorney General may invoke the aid of any court of the United States within the jurisdic-

tion of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, or other documents. Any such court may issue an order requiring such person to appear before the Attorney General or attorney designated by the Attorney General, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. The Attorney General shall have the power to make such rules relating to civil investigations as may be necessary or appropriate to implement the provisions of this subsection.

"(f) As used in this section—

"(1) The term 'domestic concern' means (A) any individual who is a citizen, national, or resident of the United States; or (B) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States, which has a class of secu-

rities registered pursuant to section 12 of the Securities Exchange Act of 1934, or which is required to file reports under section 15(d) of the Securities Exchange Act of 1934.

"(2) The term 'foreign official' means (A) any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality; or (B) any foreign political party or official thereof or any candidate for foreign political office.".

DEFINITIONS

SEC. 6. Section 13(b) of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following:

"(6) For the purpose of this section, the terms 'reasonable assurances' and 'reasonable detail' mean such level of detail and degree of assurance as would satisfy prudent individuals in the conduct of their own affairs, having in mind a comparison between benefits to be obtained and costs to be incurred in obtaining such benefits.".

EXCLUSIVITY PROVISION FOR OVERSEAS BRIBERY

SEC. 7. No criminal action pursuant to section 1341 or 1343 of title 18, United States Code, may be brought against a domestic concern, its officers, directors, employees, or any shareholders thereof acting on behalf of such domestic con-

cern for a payment, gift, offer, or promise to a foreign official based upon the theory that the foreign official or the domestic concern violated a duty to or defrauded the foreign government or the citizens of a foreign country.

AUTHORITY TO ISSUE GUIDELINES

SEC. 8. Title I of the Business Practices and Records Act is amended by adding at the end thereof the following:

"GUIDELINES AND GENERAL PROCEDURES FOR COMPLIANCE

"SEC. 105. (a) Not later than six months after the date of enactment of this section, the Attorney General, after consultation with the United States Trade Representative, the Secretary of State, the Secretary of Commerce, and the Secretary of the Treasury, and after consultation with representatives of the business community and the interested public through public notice and comment and in public hearings, shall determine to what extent the business community would be assisted by further clarification of section 104 of this Act and shall, based on such determination and to the extent necessary and appropriate, have the authority to issue—

"(1) guidelines describing specific types of conduct associated with common types of export sales arrangements and business contracts which the Attorney General determines constitute compliance with the provisions of section 104 of this Act; and

"(2) general precautionary procedures which issuers or domestic concerns may use on a voluntary basis to ensure compliance with this Act, and to create a rebuttable presumption of compliance with this Act.

The guidelines and procedures referred to in the preceding sentence shall be issued in accordance with sections 551 through 557 of title 5, United States Code.

"(b) The Attorney General, after consultation with other Federal agencies and representatives from the business community, shall establish a Business Practices and Records Act Review Procedure for the purposes of providing responses to specific inquiries concerning enforcement intentions under this Act. The Attorney General shall issue opinions, within thirty days, in response to requests from domestic concerns, regarding compliance with the requirements of the provisions of section 104 of this Act. An opinion that certain prospective conduct does not involve a violation shall be final and binding on all parties, subject to the discovery of new evidence. When appropriate, and at reasonable intervals, the responses derived from the review procedure will be reviewed by the Attorney General to determine whether such compilation of responses should be included in a new guideline pursuant to subsection (a).

"(c) Any document or other material provided to, received by, or prepared in the Department of Justice, or any

other department or agency of the United States Government, in connection with a request by a domestic concern for a statement of present enforcement intentions under the Business Practices and Records Act Review Procedure pursuant to subsection (b) of this section, or in connection with any investigations conducted to enforce this Act, shall be exempt from disclosure under section 552 of title 5, United States Code, regardless of whether the Department responds to such a request or the applicant withdraws such request prior to receiving a response. The Attorney General shall protect the privacy of each applicant, and shall adopt rules assuring that materials, documents, and information submitted in connection with a review procedure request will be kept confidential and will not be used for any purpose that would unnecessarily discourage use of the review procedure. The review procedure shall be developed and instituted in accordance with sections 551 through 557 and 701 through 706 of title 5, United States Code.

"(d) The Attorney General shall make a special effort to provide timely compliance guidance to potential exporters, and smaller businesses, who as a practical matter are unable to obtain specialized counsel on issues pertaining to this Act. Such assistance shall be limited to requests for enforcement intention disclosures provided for under this Act, and general

explanations of compliance responsibilities and of potential liabilities under the Act.

"(e)(1) On September 1 of each year the Attorney General shall transmit to the Congress and make public a detailed report on all actions which the Department of Justice has taken pursuant to this Act, along with its views on problems associated with implementation, its plan for the next fiscal year to further implement the Act, and recommendations for amendments.

"(2) On September 1 of each year the Chairman of the Securities and Exchange Commission shall file with the Congress a detailed report on all actions which the Commission has taken pursuant to section 13(b) of the Securities Exchange Act, its views on problems associated with implementation, its plans for the next fiscal year to further implement such section, and its recommendations for amendment.".

INTERNATIONAL AGREEMENTS

SEC. 9. (a) It is the sense of the Congress that the President should pursue the negotiation of an international agreement among the largest possible number of nations on illicit payments, including a process by which problems and conflicts associated with such practices could be resolved.

(b) Within one year after the date of enactment of this Act, the President shall report to Congress on—

(1) the progress of the negotiations referred to in subsection (a);

(2) those steps which the administration and Congress should consider taking in the event that these negotiations do not successfully eliminate the competitive disadvantage of United States business; and

(3) possible actions that could be taken to promote cooperation by other nations in international efforts to prevent bribery of foreign officials, candidates, or parties in third countries.

This report shall also include recommendations for any new legislation required to give the President authority to take appropriate action to achieve such objectives. The report shall contain an analysis of the potential effect on the interests of the United States including United States national security of the corruption of foreign officials and political leaders in connection with international business transactions involving persons and business enterprises of other nations. In addition, the report shall assess the current and future rule in curtailing such corruption of private initiatives such as the Recommendations to Government and Rules of Conduct to Combat Extortion and Bribery developed by the International Chamber of Commerce.

Senator HEINZ. At this time, I'd like to yield to the ranking member of this committee on the Democratic side, Senator Proxmire, who's been an articulate critic of this bill. He isn't always right, but he's very articulate. He's often right, even if he's not always right on this bill. Senator Proxmire.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Thank you, Mr. Chairman. I think I'm right on this bill, believe me. The bill before us this morning is the "bring back bribery" bill, to be blunt about it. I'm going to call it that from now on at every opportunity.

It's wholly unnecessary, and unjustified. Congress should kill it. I say that as the author of the original law, the original Foreign Corrupt Practices Act, that became law in 1977.

The pending bill would destroy, would gut, the 1977 law that has served this country so well. Frankly, Mr. Chairman, I'm distressed that so many of the witnesses we have this morning say they favor the law; they just want to clarify the ambiguities. Well, good luck. If we follow their recommendations, as I think we can demonstrate, there won't be a law that will have any real respect.

In 1977 the Congress unanimously passed the Foreign Corrupt Practices Act in response to revelations about the worst domestic and foreign bribery slush fund scandal in American corporate history. Investigations into the illegal corporate contributions to President Nixon's 1972 reelection campaign made clear that such illegalities were made possible by off-the-books slush funds being maintained by over 300 major corporations. A subsequent SEC investigation of such slush funds revealed that more than 450 corporations maintained them and had used them over a period of years to make over $300 million in payments to win foreign sales. Many members of the board of directors of the relevant corporations pleaded ignorance about such misuse of corporate funds.

Those revelations demonstrated that there were real shortcomings in our Government's ability to police such actions. In March 1976, President Ford established a Cabinet level task force to examine the problem of corporate bribes to win foreign sales. In doing so, he said:

> Corrupt business practices strike at the very heart of our own moral code and our faith in free enterprise. As to American corporations, the United States Government bears a clear responsibility to bring such practices to a halt.

Other investigations in 1976 and 1977 revealed that American corporations had made questionable payments to Government officials and agents in the Netherlands, Iran, France, Germany, Saudi Arabia, Brazil, Malaysia, and Taiwan.

During our hearings on the Foreign Corrupt Practices Act we in Congress concluded that corrupt payments to foreign officials caused serious damage to America's national interest in critical areas of the world.

Lockheed Corp.'s payment of $1.6 million to Prime Minister Tanaka of Japan caused the Prime Minister's resignation and later his criminal conviction. Allegations about Lockheed's payments to Prime Minister Bernhardt of the Netherlands almost caused the monarchy to collapse in that country. Payments of more than $50

million to Italian political candidates resulted in a scandal that brought substantial election gains to the Communist Party in Italy.

The question before the Congress in 1977 was whether we should permit some dishonest corporations to harm our foreign policy interests in their zeal for sales and profits. We answered "no" unanimously—unanimously. Congress considered then that bribes are bad business because they distort free markets. Goods should be sold on the basis of price, of quality, of service, not on the basis of bribes.

We also concluded bribes were bad politically as they undermine confidence in America's integrity and corrupted other governments including the developing democratic institutions in the Third World.

Congress in 1977 found no country—no country—where bribing officials to win sales was not against the law. So the defense that bribes were a way of life in some countries did not mean the people of those countries want such behavior to be the norm. Just as Americans do not want foreign corporations bribing our officials, so do people in other lands resent such practices by our corporations in their countries.

Mr. David Newsome, a former career diplomat who became an Ambassador and Under Secretary of State for Political Affairs, testified in the House in 1983 on proposed amendments to the FCPA. He said he had personally seen revolutions detrimental to United States interests take place in both Iraq and Libya. In both cases, he said:

> The degree of corruption in the regime was a factor in the loss of public confidence that made a successful revolution possible.

Look at the cost to America today of the revolution in Libya that brought Colonel Quadhafi to power. It demonstrates that in considering whether the FCPA causes our companies to lose sales, we should not imagine that there are not long-term costs of permitting our companies to make bribes in order to win sales. The ultimate cost of such corruption can later come back to haunt us as it has done in spades in Libya and Iran.

The Foreign Corrupt Practices Act attempts to stop corporate bribery by preventing U.S. corporations from establishing slush funds to carry out such illegal activities. It does this by requiring them to maintain accurate records and accounting control systems. It also makes it illegal for U.S. corporations to bribe foreign officials either directly or through an agent. The FCPA law has been successful.

Evidence indicates that it has stopped utilization of slush funds by American corporations. It has deterred the corruption of foreign government officials by U.S. corporations.

I'd like to insert into the record and bring to the attention of the committee a recent article in the Journal of International Business Studies by Assistant Prof. John Graham of the University of Southern California's School of Business.

The article is entitled "The Foreign Corrupt Practices Act: A New Perspective." It uses published trade statistics and other Government reports to demonstrate that the FCPA was found to have no negative effect on the export performance of American industry.

Let me just take a minute to quote from that article.

Senator HEINZ. Without objection, it will be included in the record.

[The following material was subsequently supplied for the record:]

THE FOREIGN CORRUPT PRACTICES ACT: A NEW PERSPECTIVE

JOHN L. GRAHAM*
University of Southern California

Abstract. The Foreign Corrupt Practices Act (FCPA) was found to have no negative effect on the export performance of American industry. Market share of U.S. industry in countries where the FCPA is reported to be an important trade disincentive was compared with U.S. market share in other countries. No differences were discovered.

INTRODUCTION

■ Perhaps the strongest criticism of the Foreign Corrupt Practices Act (FCPA) of 1977 has been the "competitive disadvantage" argument. That is, the law has had a negative impact on U.S. industry relative to European and Japanese competitors, who freely continue to use payments to key foreign officials as a promotional device. The evidence most often cited to support this hypothesis is found in the results of a series of opinion surveys of executives [for example, Peat, Marwick, Mitchell and Co. 1979; U.S. Department of Commerce 1980; Kim 1981]. In these studies, many of the company representatives polled reported losing business to foreign competitors, and an even larger majority tended to support the "competitive disadvantage" argument in general. For a more extensive presentation of this point of view, see Kaikati and Label [1980].

One researcher, however, using similar survey methods, has reported different conclusions. Richman [1979] suggests that often improper payments made overseas are ineffective in gaining business for American firms. Instead, business has been lost to other American firms; agents or employees have failed to pass along the payments; or the contracts might have been won without the payments. Additionally, he reports, "Quite a few of the firms that have disclosed large improper payments and have since refused to make such payments are experiencing high, if not record, revenues, profits, and backlogs" [Richman 1979, page 16]. Moreover, Richman indicates that the amount of business lost to foreign competitors because of the FCPA is inconsequential.[1]

Up until now, the resolution of these conflicting reports has been impossible. The GAO has concluded, "Claims that U.S. companies have lost sales, however, are difficult, if not impossible, to substantiate and quantify because of the sensitivity of the bribery subject and the numerous factors affecting overseas business" [U.S. General Accounting Office 1981, page 16]. Recently published trade statistics and other government reports, however, provide the data for a test of the "competitive disadvantage" hypothesis. The results of this test indicate that the FCPA has not negatively affected the competitive position of American industry in the world marketplace.

The remainder of this paper is divided into 4 sections. First, the hypothesis to be tested is specified. Second, the methods used in the analysis are described. Third, results are reported. Finally, a discussion and interpretation of the findings are presented, including mention of the limitations of the approach.

HYPOTHESIS

As mentioned previously, there is wide agreement among executives that American firms have lost business to foreign competitors because of the FCPA. Particularly in those countries where improper payments are common, American

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firms constrained by the FCPA purportedly have a substantial disadvantage. It is expected that American sales to such countries have declined relative to foreign competitors since the inception of the FCPA. Or, precisely stated:

H. The Foreign Corrupt Practices Act has negatively affected the United States' share of imports to those countries where improper payments are common practice.

Operational definitions of terms are presented in the next section.

METHOD

To test the hypothesis, data from several sources have been integrated and analyzed.

Prevalence of Improper Payments

During 1980, the Commerce Department consulted U.S. Foreign Service posts regarding their views on export promotion and export disincentives. Responses were received from 51 embassies, representing countries accounting for 80 percent of total U.S. exports in 1979 (see Table 1). The report summarizes the embassies' comments regarding the FCPA:

> Nineteen[2] embassies reported that the Foreign Corrupt Practices Act constituted an export disincentive. Posts commented that the uncertainty perceived by U.S. businessmen and the lack of clear guidelines in the Act hindered doing business abroad. Posts also noted that businessmen often tended to err on the side of caution, foregoing potential export sales rather than risk litigation.
>
> The most significant reported problems with the FCPA arose in those countries where "grease" payments are an accepted means of doing business or anywhere that third country suppliers "play by a completely different set of rules." Perhaps the best example of the effect of the FCPA on U.S. exports comes from the embassy in Oman.
>
> > Local U.S. lawyer reports that recently $20-30 million deal was lost to U.S. firm largely because of delays caused by lengthy struggle to ensure FCPA compliance. Same lawyer indicates that a $20 million deal was definitely lost to U.S. firm because Omani Government official/businessman with whom U.S. firm was attempting to deal was insulted and exasperated by firm's attempts to protect itself against possible future FCPA security. Kindest comment that post has heard from Omani about FCPA is that it is "stupid." Overall economic loss to American business resulting from FCPA is unknown but surely major.

Based on the embassies' responses, the 51 countries are classified according to the prevalence of improper payments and the associated negative impact of the FCPA on American firms doing business there. Two classification schemes were used to quantify the reports of the embassies. First, a dichotomous variable (V1) was created by separating the countries into 2 groups—one where the FCPA was not mentioned as an export disincentive (Group 0), and one where the FCPA was mentioned (Group 1). A second, ordinal variable (V2) was created by evaluating the impact of the FCPA on a 4-point scale—major, significant, minor, or no impact. The countries and associated coding are listed in Table 1.

A third, geographical coding scheme was used in the study. Basche [1976] suggests that improper payments are more prevalent in Latin America, the Middle East, the Far East, Africa, and in less developed countries in other regions. Each country was classified according to this geographical scheme to create another dichotomous variable, V3.

Finally, the *Business Periodical Index* and the *Wall Street Journal Index* were searched for all articles regarding bribery, improper payments, the FCPA, and so on, for the period 1975–81. Each separate reported instance of bribery and the country where the payment was made were recorded and tallied to yield V4 (see Table 1). Thus, the listing of V4 indicates that 3 separate instances of improper payments in Argentina were reported during the period; one in Australia; and so on.

TABLE 1

The Differential Impact of the FCPA

	Impact of FCPA (Commerce Department 1980)		Geographical Scheme (Conference Board 1976)	Other Sources
	V1*	V2*	V3*	V4*
Bahrain	0	0	1	0
Belgium/Luxembourg	0	0	0	1
Chile	0	0	1	2
Ecuador	0	0	1	0
Finland	0	0	0	0
France	0	0	0	1
East Germany	0	0	0	0
West Germany	0	0	0	6
Ghana	0	0	1	1
Iceland	0	0	0	0
India	0	0	1	1
Iraq	0	0	1	1
Ireland	0	0	0	0
Jamaica	0	0	0	2
Jordan	0	0	1	0
Lebanon	0	0	1	1
New Zealand	0	0	0	0
Norway	0	0	0	1
Qatar	0	0	1	1
South Africa	0	0	0	0
Spain	0	0	0	2
Switzerland	0	0	0	3
United Kingdom	0	0	0	2
Argentina	1	2	1	3
Australia	1	1	0	1
Bangladesh	1	2	1	0
Egypt	1	2	1	7
Indonesia	1	2	1	4
Japan	1	2	1	13
Kenya	1	1	1	2
South Korea	1	2	1	6
Kuwait	1	1	1	1
Liberia	1	2	1	0
Mexico	1	2	1	9
Netherlands	1	1	0	4
Nigeria	1	3	1	1
Oman	1	2	1	1
Philippines	1	2	1	5
Saudi Arabia	1	2	1	18
Singapore	1	2	1	1
Syria	1	2	1	1
Turkey	1	3	1	2
United Arab Emirates	1	2	1	1
Venezuela	1	2	1	5

The reliability and convergent validity of the 3 schemes were assessed and the results reported in Table 2. The Commerce Department Classification Scheme (V1 and V2) is highly correlated with both the geographical scheme (V3) and the tally of improper payments (V4), and was therefore selected as the best measure of the expected differential impact of the FCPA.

TABLE 1

The Differential Impact of the FCPA (cont'd)

	Impact of FCPA (Commerce Department 1980)		Geographical Scheme (Conference Board 1976)	Other Sources
	V1*	V2*	V3*	V4*
Austria	—	—	0	3
Canada	—	—	0	3
Czechoslovakia	—	—	0	0
Greece	—	—	0	2
Italy	—	—	0	15
Morocco	—	—	1	2

*V1 1 = FCPA mentioned (Group 1)
0 = FCPA not mentioned (Group 0)
blank = not reported

*V2 0 = no impact
1 = minor impact
2 = significant impact
3 = major impact
blank = not reported

*V3 1 = improper payments common
0 = improper payments uncommon

*V4 number of separate bribery incidences in each country reported in U.S. business literature 1975 to 1981

TABLE 2

Reliability and Validity of Classification Schemes
(Pearson Correlation Coefficients, N = 44)

		V1	V2	V3	V4
Commerce Department	V1	1.000			
study	V2	.934*	1.000		
Geographical scheme	V3	.553*	.582*	1.000	
Other sources, news references	V4	.415*	.407*	.114*	1.000

*$P < 0.005$

Share Data The United States' share of trade to each country for each year was compiled using 4 sources. The information gathered is summarized in Figures 1 and 2. Total U.S. share of merchandise shipments (that is, all SITCs) were calculated using 3 data bases: Data Resources, Incorporated [DRI 1982]; the *1979 Yearbook of International Trade*, published by the United Nations [1980]; and Business International Corporation [BI/Data 1982]. Only DRI provided data through 1980. The differences in levels of U.S. market share between the sources is substantial and can be attributed primarily to differences in the countries included in the denominator of the share calculation, and secondarily to errors and omissions of the different sources.

U.S. market share for separate SITC categories is published by the U.S. Commerce Department. Only data for 1975–79 are available. The categories are listed in Table 3 along with the dollar value of U.S. shipments in 1979 to provide an indication of the relative importance of each category.

The individual data sources should be consulted for more detail regarding definitions, sources, limitations, and other technical details. The Commerce

TABLE 3

Product Classes Included in the Study

SITC #	Name	U.S. Shipments, 1979
541	medicinal and pharmaceutical products	$ 1.7 billion
71	nonelectric machinery	$ 32.4 billion
722.1	electrical power machinery	$ 1.2 billion
734.1	aircraft (heavier than air)	$ 7.0 billion
	total trade	$173.0 billion

Department data included the following disclaimer regarding the aircraft category:

> In the tabulations for certain categories, complete U.S. export data by country of destination are not published for security reasons. For these commodities, the value of exports not shown by destination is given as "special category" at the end of the country listing. The principal commodities affected are aircraft, aircraft engines, and military vehicles.

Analysis

Analysis of variance was used to determine if the hypothesized differences between groups exist. Specifically, changes of share of imports for the United States were calculated for 7 periods using the following formula:

$$\Delta S_t = S_t - S_{t-1} \quad (1)$$

where:

S = U.S. share of imports
ΔS = change in share of imports
t = time period

Changes in share of imports between 1971–72 and 1975–76 (pre FCPA periods) were chosen as controls. Changes in share between 1977–78, 1978–79, 1979–80, 1977–79, and 1977–80 were analyzed to test the hypothesis. Identical analyses were completed for each data base and each SITC category. Results are reported and compared in the section to follow.

RESULTS

Presented below are the results of various tests of the "competitive disadvantage" hypothesis. First, the results regarding U.S. share of total trade (all SITCs) are listed. Next, findings related to individual product categories are discussed.

U.S. Share of Total Trade (all SITCs)

As can be seen in Table 4, no support for the "competitive disadvantage" hypothesis was discovered. No statistically significant differences between U.S. trade performance in the 2 groups were discovered in either the control or test periods. The results listed in Table 4 represent the tests run using only the DRI data base. Those results are presented in detail because the DRI data are the most complete (that is, in years and reporting countries), and these results are consistent with those tests run using the U.N. data and the BI/DATA data. There is, however, one exception to this consistency across the 3 data bases. In the period 1978–79, a statistically significant difference was discovered in U.S. trade performance reported in the U.N. data. See Table 5 for details.

This latter finding is particularly important because the effects of the FCPA might be expected to be most noticeable during 1978–79. The FCPA was passed by Congress in late 1977, thus primarily influencing transactions during 1978. As mentioned earlier, the trade statistics represent shipments, most of which would have been ordered during those 1978 transactions. Thus, the period 1978–79 is focused upon in the discussion to follow.

As indicated in both Figure 1 and Table 5, during 1978–79 the U.S. share of trade

61-592 O - 86 - 2

FIGURE 1

U.S. Share of Imports for 2 Groups of Countries

Source: Data Resources, Inc.

Source: United Nations (for 1979 only 29 countries reported.)

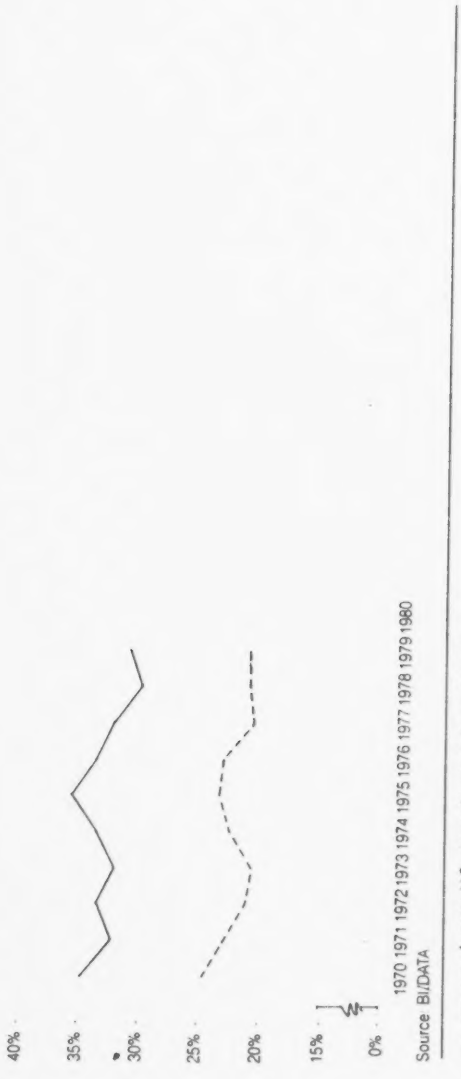
40%
35%
30%
25%
20%
15%
0%
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980
Source BI/DATA
— — — Average U S share of trade to Group 0 countries
———— Average U S share of trade to Group 1 countries

FIGURE 2
U S Share of Trade by SITC to 2 Groups of Countries

35%
30%
25%
20%
15%
10%
5%
0%
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980
Electric power machinery, SITC 722.1
70%
65%
60%
55%
50%
45%
40%
0%
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980
Aircraft, SITC 734.1
— — — Average U.S. share of trade to Group 0 countries.
——— Average U.S. share of trade to Group 1 countries.
Source: Commerce Department.

TABLE 4

Analysis of Variance: Hypothesis Tests, V1* by ΔS, Total Trade, DRI Data Base

Periods of change	Source	Degrees of freedom	Sum of squares	Mean square	F ratio	F probability	Group means
Control Periods							
1971–72	between	1	.001	.001	.716	.403	Group 0 = −.013 (N=22)
	within	40	.063	.002			Group 1 = −.002 (N=20)
	total	41	.065				Total = −.008 (N=42)
1975–76	between	1	.002	.002	1.30	.262	Group 0 = .009 (N=23)
	within	42	.073	.002			Group 1 = −.006 (N=21)
	total	43	.075				Total = .002 (N=44)
Test Periods							
1977–78	between	1	.001	.001	.712	.404	Group 0 = −.011 (N=23)
	within	42	.039	.001			Group 1 = −.003 (N=21)
	total	43	.040				Total = −.007 (N=44)
1978–79	between	1	.001	.001	1.78	.189	Group 0 = .004 (N=23)
	within	42	.025	.001			Group 1 = .014 (N=21)
	total	43	.026				Total = .009 (N=44)
1979–80	between	1	.000	.000	.062	.805	Group 0 = .020 (N=23)
	within	42	.021	.001			Group 1 = .019 (N=21)
	total	43	.021				Total = .020 (N=44)
1977–79	between	1	.003	.003	2.02	.163	Group 0 = −.007 (N=23)
	within	42	.071	.002			Group 1 = .011 (N=21)
	total	43	.075				Total = .002 (N=44)
1977–80	between	1	.003	.003	1.56	.219	Group 0 = .013 (N=23)
	within	42	.076	.002			Group 1 = .029 (N=21)
	total	43	.078				Total = .021 (N=44)

* Group 0 = countries where embassies did not mention FCPA as a trade disincentive.
Group 1 = countries where embassies mentioned FCPA as a trade disincentive.

TABLE 5

Analysis of Variance. A Comparison of Results across Data Bases, V1* by ΔS, Total Trade (all SITCs) 1978–79

Data base	Source	Degrees of freedom	Sum of squares	Mean square	F ratio	F probability	Group means
DRI	between	1	.001	.001	1.78	.189	Group 0 = .004 (N=23)
	within	42	.025	.001			Group 1 = .011 (N=21)
	total	43	.026				Total = .009 (N=44)
United Nations	between	1	.001	.001	17.2	.0005	Group 0 = −.003 (N=12)
	within	21	.001	.000			Group 1 = .011 (N=11)
	total	22	.002				Total = .004 (N=23)
BI/DATA	between	1	.001	.001	.775	.391	Group 0 = .000 (N=19)
	within	35	.054	.002			Group 1 = .012 (N=18)
	total	36	.055				Total = .006 (N=37)

* Group 0 = countries where embassies did not mention FCPA as a trade disincentive.
Group 1 = countries where embassies mentioned FCPA as a trade disincentive.

increased in Group 1 countries at a faster rate than in Group 0 countries. Indeed, using the data available from the United Nations, U.S. market share actually decreased in Group 0 countries. Moreover, the difference between the change in shares for the U.N. data is statistically significant ($p < 0.05$). These findings tend to refute the "competitive disadvantage" hypothesis.

Individual SITC Categories

The results of the statistical analyses for 4 SITC product categories are highlighted in Table 6. As suggested by the information there and in Figure 2, the "competitive disadvantage" hypothesis receives no support. Particularly in the primary test period, 1978–79, no statistically significant differences were found between groups for any product category. An examination of the results in other periods (that is, test and control) yields only 2 statistically significant differences between U.S. share of trade to the 2 groups of countries. First, for SITC #541 in the control period 1975–76, U.S. share increased in Group 0 countries and decreased in Group 1 countries, and the difference was statistically significant ($p < 0.05$). Second, a borderline difference ($p < 0.10$) was discovered for SITC #734.1 during the test period 1977–78. Here the U.S. share of aircraft shipments increased to Group 1 countries and decreased to Group 0 countries. This latter finding is in opposition to the "competitive disadvantage" hypothesis.

DISCUSSION AND INTERPRETATION OF FINDINGS

The consistent lack of support for the "competitive disadvantage" hypothesis suggests several possible conclusions. The most obvious and attractive explanation is Richman's [1979] proposition that improper payments are for the most part ineffective in the short run and particularly damaging to the firm in the long run. That is, if improper payments have no effect on U.S. firms' competitive performance in the first place, then a statute which serves to discourage companies from making them will have no negative effect on competitive performance. Indeed, the findings in Tables 5 and 6 tend to support Richman's point of view.

The findings regarding the U.S. share of aircraft sales (SITC #734.1) deserve special attention. Improper payments to foreign officials are a particular concern for the aircraft industry—as indicated by the frequent reports of charges and indictments in the press and other business literature. Unfortunately, the data for this product class are the least reliable (that is, have the most omissions because of security considerations). Also, individual sales are much larger and less frequent leading to the highly volatile U.S. share figures presented in Figure 2. For example, in more than one country, U.S. market share varies as much as 100 percent from one period to the next.

Despite these limitations, the U.S. share of aircraft sales appears to have increased steadily in the Group 1 countries since the inception of the FCPA. Alternatively, the U.S. share of aircraft sales decreased dramatically in the Group 0 countries during 1978. Therefore, the best, albeit very weak, evidence available indicates that the effect of the FCPA on U.S. aircraft sales abroad is not negative.

Limitations

Aside from Richman's "positive effect" hypothesis, several rival explanations must also be considered.

First, one particularly unsettling explanation for the findings reported is that the FCPA itself has not been effective in discouraging improper payments. That is, American firms have found ways to circumvent the reporting requirements and detection of authorities. Kaikati and Label [1980] indicate this to be the case. However, the high level of industry complaints suggests otherwise.

Second, it has been posited that the negative impact of the FCPA is particularly damaging in specific industries (for example, construction industry and/or aircraft industry). As suggested above, this appears not to be the case—at least for the 4 product categories investigated.

TABLE 6

Analysis of Variance: A Comparison of Results
across Product Categories, V1* by ΔS, Commerce Department Data, 1978–79

SITC	Source	Degrees of freedom	Sum of squares	Mean square	F ratio	F probability	Group means
SITC #541	between	1	.000	.000	0.87	.770	Group 0 = −.006 (N=21)
(medicinal	within	39	.042	.001			Group 1 = −.009 (N=20)
products)	total	40	.042				Total = −.075 (N=41)
SITC #71	between	1	.001	.001	882	.353	Group 0 = .007 (N=21)
(nonelectric	within	39	.053	.001			Group 1 = .018 (N=20)
machinery)	total	40	.054				Total = .012 (N=41)
SITC #722.1	between	1	.011	.011	1.36	.251	Group 0 = −.032 (N=21)
(electric power	within	39	.303	.008			Group 1 = .001 (N=20)
machinery)	total	40	.314				Total = −.016 (N=41)
SITC #734.1	between	1	0.07	.073	.747	.393	Group 0 = .143 (N=21)
(aircraft)	within	39	3.82	.098			Group 1 = .058 (N=20)
	total	40	3.88				Total = .102 (N=41)

* Group 0 = countries where embassies did not mention FCPA as a trade disincentive.
Group 1 = countries where embassies mentioned FCPA as a trade disincentive.

Third, the results of the survey of embassies [U.S. Department of Commerce 1980], upon which the classification of the countries is based, might be faulty. However, a reasonable degree of agreement between classification schemes and sources was found.

Fourth, other export incentives/disincentives far overshadow the effects of the FCPA. Indeed, a plethora of factors can potentially influence America's export share to any one country. Such factors as government financing and trade subsidies, changes in expatriate income tax laws, export controls, supply considerations, and currency fluctuations might affect a country's trade performance. However, the methods of data analysis employed in this study (that is, analysis of variance and market share statistics) serve to focus attention on the variance in trade performance based solely on the differential impact of the FCPA. For example, it is assumed that a decrease in the value of American currency would tend to affect trade positively to countries in both Categories 0 and 1 equally. Likewise, an increase in the value of Mexican currency would tend to affect positively imports from Japan and the EEC, as well as the United States. The findings of this study suggest that the variance of America's trade performance across the 50 countries is due primarily to such other factors as listed above, and the business lost because of anti-bribery legislation is inconsequential by comparison.

Fifth, the 2 groups of countries differ in other respects besides the differential impact of the FCPA (for example, the structure of imports—food versus machinery, and so on). It may be that differential market performance of particular sectors of American industry supersedes the impact of the FCPA. Sternitzke [1979], however, found such structural or product mix considerations to be inconsequential in the years 1967–77. That is, during 1967–77 market share has been lost by American industries equally across sectors of the economy—agriculture to machinery, and so on. Moreover, the author's own analysis of more recent data suggests no significant difference in the mix of imports between the 2 groups of countries. For example, food and beverage imports (SITC #1) amount to 10 percent of total value of imports for both Group 1 and Group 0 countries (V1). Imports of machinery (SITC #4) are 21 percent and 19 percent of the total value of imports for Group 1 and Group 0 countries (V1), respectively. The latter difference is not statistically significant.

Management and Policy Implications

The findings of the study have important implications for both management and government policymakers. Evidence is provided which tends to refute the perception of business leaders that the FCPA has hurt the competitive position of American industry. Support is provided for Richman's [1979] propositions that improper foreign payments are at least unnecessary and perhaps counterproductive. Although these findings are macroeconomic in nature, the associated management implication is that funds spent to influence key decision makers improperly in foreign firms and governments should be questioned on economic grounds (that is, just as other promotional expenditures are scrutinized), as well as ethical and legal grounds. A discussion of other related management issues—ethical and legal, as well as economic—can be found in Graham [1983]. Perhaps resources are really better spent in improving products and services, rather than in questionable payments and the like.

Although the findings and conclusions presented in this study tend to counter the "competitive disadvantage" claims made by American business leaders, the FCPA itself can and should be improved. The amendments now being considered in Congress, however, appear to emasculate the law, rather than improve it [compare Wirth 1983]. Hopefully these potentially damaging changes to the statute will continue to be stalled in subcommittees and eventually replaced by more useful amendments. Clarification of the law will lead to more cooperation

from industry and more efficient enforcement of the law—both factors contributing to the improvement of America's participation in the worldwide marketplace.

FOOTNOTES

1. It should be noted that a more definitive examination and discussion of Richman's work is not possible. Unfortunately, his raw data (that is, questionnaires) are not available and he is deceased.

2. Twenty-one is the correct number of embassies listing the FCPA as a trade disincentive [U.S. Department of Commerce 1980, pp. C-6 to C-14].

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Senator PROXMIRE. Thank you, Mr. Chairman.

Graham identified 51 countries that account for 80 percent of U.S. trade in 1979 as either bribe prone or nonbribe prone, with such nations as Saudi Arabia, Italy, Japan, and the Netherlands falling into the first category. He based the classification on the findings of a Commerce Department survey of U.S. Embassy specialists who monitor the business climates of their host countries, as well as a review of all media-reported bribery scandals occurring during the 1970's.

He then analyzed both total trade figures and trade data in four individual industries—pharmaceuticals, nonelectric machinery, electric power machinery and aircraft—to examine the effect of the act on U.S. exports.

What did he find? He found that during the 1978–79 period when the full impact of the 1977 act would be expected to show up, it had no negative effect on the export performance of American industry.

Furthermore, no differences of the U.S. market share were discovered in nations where the act is reported to be an important trade disincentive both in terms of total trade with each country as well as for sales of individual product categories.

Since the enactment of the FCPA in 1977, U.S. trade in bribe-prone countries actually outpaced our trade with nonbribe-prone countries, leading Graham to believe that improper payments are at least unnecessary and perhaps even counterproductive, and the impressions of American business executives concerning the necessity of foreign payoffs was mistaken.

Now that's a documentation. That's not just a theory. I notice in reading the testimony of the witnesses this morning they make charges, as the chairman did in his opening statement, that this act is losing business for this country. Here's documentation that it isn't.

Since early 1981, the Reagan administration, joined by a vocal group of trade lobbyists, has pushed legislation to amend the Foreign Corrupt Practices Act. Advocates of amending the act all contend they do not want to reverse the original judgment of Congress that forthrightly condemned bribery as a means for winning foreign sales. Still, the bill reported out by this committee in 1981 and 1983, which is before us today, does contain loopholes that could make foreign bribery rampant once again.

Finally, Mr. Chairman, I would like to read from an editorial in the New York Times on this identical bill when it was before us in 1983.

> Mindless moralism—that's the charge some American companies still make about congressional action forbidding bribery of foreign officials to secure business. Americans may be pious about business methods at home, the argument goes, but they have to understand that grease is essential to doing business in foreign lands with foreign moral standards.

The trouble with this argument is that those who make it have never been able to prove it and now their case has been dealt a firm blow by the bribery conviction of Japan's former Prime Minister Tanaka. His bribe taking and the Lockheed Corp. bribe giving offended moral standards on both sides of the Pacific. Mr. Tanaka took $2 million to get All-Nippon Airlines to buy a fleet of jetliners from Lockheed. American law did not directly prohibit foreign

bribery when this offense was hatched a decade ago. Congress fixed that with the 1977 law but has been besieged ever since by lobbyists who claim the law harms American exports. This Tanaka verdict is a reminder that America would be harmed much more by winking at corruption.

The Justice Department had to do an "Al Capone" on Lockheed. Lacking a statute directly forbidding such bribery, it prosecuted Lockheed for false declarations in connection in the plane sale financing. The penalty was trivial. Lockheed's plea bargain sentence was $847,000 in criminal fines and civil penalties on Jet Star sales of $430 million. No officials were prosecuted. The punishment meted out to Mr. Tanaka more nearly fits the crime—4 years in prison and a fine equal to his $2 million bribe.

Had it happened after 1977, the American prosecutors would have had an easier time. That was when Congress moved by a sickening trail of grease passed the Foreign Corrupt Practices Act. Government records showed $300 million in foreign bribes and questionable payments by 450 U.S. corporations.

The act attacked the two main tools of corruption—phony bookkeeping and purposeful ignorance about bribes buried in marketing and promotion budgets. The law made it a crime for individuals as well as companies to maintain inaccurate books and to pass money to agents abroad when there is reason to know it would be used corruptly.

Has the law worked? Too well. Business groups have complained. Two years ago they persuaded the Senate to pull its teeth. Where the 1977 law sensibly exempted small payments like those that facilitated dockside unloading, the 1981 bill called for a loophole big enough to fly all of Lockheed through. Instead of holding exporters to the duty to know where the money was going, the Senate would have required prosecutors to prove a direct order to pay a bribe. So far, House members have been more conscientious. They have insisted that the companies prove both that the existing law hurts commerce and that honest businesses seeking to obey the law are experiencing intolerable difficulties. An identical bill has already cleared the Senate Banking Committee and may win Senate approval. Both Houses had better look closer at this bill and resist the pressures behind it.

The law has an important self-policing effect. Corporations are nervous about fees that could look like bribes and hire high-priced lawyers to advise them on their legality. Such prudence has made the law effective even though the Justice Department and the Securities and Exchange Commission assign it low enforcement priority.

Few doubt that the law, had it been on the books in 1972, would have deterred Lockheed from approaching the Japanese leader with the offer he promptly accepted. How much better it is that the United States export principles than export grease. I have concluded my reading of the 1983 New York Times editor commenting on a bill identical to S. 430. Thank you, Mr. Chairman.

Senator HEINZ. Senator Proxmire, thank you.

Senator Dixon.

Senator DIXON. Mr. Chairman, I will put a complete statement in the record but let me read very briefly about one page from that statement.

Mr. Chairman, let me say at the outset that I think it is vital to the national interests of the United States to have a strong and vital Foreign Corrupt Practices Act. The consequences of failure to have effective antibribery prohibitions were all too apparent in the days before that statute was enacted.

The bill before the committee today is designed to improve the antibribery statute, while simplifying it and making it more understandable for the businesses that have to work under its provisions on a day-in, day-out basis. The standards currently in the act, because they are somewhat vague, do in some cases cost U.S. companies more in compliance costs than is necessary to achieve its goals. They also act to create some disincentives for U.S. businesses to compete for sales in some parts of the world.

I do not believe there is a conflict between the need to clarify and simplify the Foreign Corrupt Practices Act and the need to maintain strong antibribery sanctions on the other. U.S. export competitiveness can be improved by amending the statute, but U.S. businesses, as well as the American Government, know we are not well served by a statute that would permit, or appear to permit, bribery of foreign officials in order to obtain sales. Ineffective prohibitions would cost many more sales in the long run than a strong statute, even without considering the enormous international political risks involved.

I am pleased, therefore, that the bill before the committee today is designed to build on the strengths of the current law, making only those changes necessary to clarify ambiguities in the statute, to simplify its operation and to make it more workable and understandable for U.S. exporters.

Mr. Chairman, I ask that the balance of my remarks be placed in the record.

Senator HEINZ. Senator Dixon, without objection, so ordered.

[The complete prepared statement follows:]

STATEMENT OF SENATOR ALAN DIXON

Mr. Chairman, I am pleased to be here this morning as the Banking Committee hears testimony on S. 430, the Business Accounting and Foreign Trade Simplification Act. This bill is very similar to S. 708, which was reported out of the Banking Committee in 1981. It is also virtually identical to S. 414, which this committee reported in 1983, so this is the third Congress in which the Banking Committee has considered legislation designed to improve and clarify the Foreign Corrupt Practices Act.

I have a real interest in this issue. I was very active in the long, drawn-out negotiations that produced the compromise legislation the committee ultimately acted on in 1981.

Let me say at the outset that I think it is vital to the national interests of the United States to have a strong and vital Foreign Corrupt Practices Act. The consequences of failure to have effective antibribery prohibitions were all too apparent in the days before that statute was enacted.

The bill before the committee today is designed to improve the antibribery statute, while simplifying it and making it more understandable for the businesses that have to work under its provisions on a day-in, day-out basis. The standards currently in the act, because they are somewhat vague, do, in some cases, cost U.S. companies more in compliance costs than is necessary to achieve its goals. They also act to create some disincentives for U.S. businesses to compete for sales in some parts of the world.

I do not believe there is a conflict between the need to clarify and simplfy the Foreign Corrupt Practices Act, and the need to maintain strong antibribery sanctions, on the other. U.S. export competitiveness can be improved by amending the statute, but U.S. business, as well as the American Gove nment, know we are not well-served by a statute that would permit, or appear to permit, bribery of foreign officials in order to obtain sales. Ineffective prohibitions would cost many more sales in the long run than a strong statute, even without considering the enormous international political risks involved.

I am pleased, therefore, that the bill before the committee today is designed to build in the strengths of the current law, making only those changes necessary to clarify ambiguities in the statute, to simplify its operation and to make it more workable and understandable for U.S. exporters.

We have a distinguished group of witnesses before the committee today. I look forward to receiving the benefits of their views and recommendations, and to working with my colleagues to report a reasonable and appropriate bill. Since the House of Representatives has finally acted on its package of changes in the Foreign Corrupt Practices Act, the time may have finally come when we can enact legislation and complete this 6-year effort.

Senator HEINZ. Senator Gorton.

Senator GORTON. Thank you, Mr. Chairman. I appreciate your holding this hearing and I look forward to hearing from the Secretary.

Senator HEINZ. Senator Gorton, thank you.

Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman. I would like to thank Secretary Baldrige for coming today to comment on S. 430, amendments to the Foreign Corrupt Practices Act.

U.S. businesses need the guidelines and definitions that are included in this bill to be able to compete effectively in international markets. I look forward to your comments on this proposal. Thank you.

Senator HEINZ. Senator Hecht, thank you.

Secretary Baldrige, we're delighted to have you here. I want to commend you on something. This is your second hearing this morning. You were down in the Finance Committee I understand at 9:30 testifying.

Mr. BALDRIGE. That's a mixed blessing, Mr. Chairman.

Senator HEINZ. Now you're up here testifying on the FCPA.

Before we start, let me just recognize the cochairman of this hearing. It is a joint hearing of the Securities Subcommittee and the International Finance and Monetary Policy Subcommittee. Senator D'Amato from New York, if you have any opening statement, please proceed.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Mr. Chairman, I commend you for calling this hearing and say that it's always good to see Secretary Baldrige, who does a great job and is a good and dear friend of this Senator. I don't know if he wants to admit to it all the time, but he certainly has done a great job and it's good to see you, Mr. Secretary.

This morning the Securities Subcommittee and the International Finance and Monetary Policy Subcommittee are examining legislation designed to amend the Foreign Corrupt Practices Act [FCPA] of 1977. The legislation before us, S. 430 the Business Accounting and Foreign Trade Simplification Act, is designed to remedy certain aspects of the FCPA which have proven to be troublesome to U.S. companies trying to compete in international markets.

Amendments to the FCPA are needed because, in practice, the FCPA has proven to be unnecessarily complex and confusing. No doubt some of the problems stem from the fact that when Congress enacted the FCPA it embarked on previously uncharted waters. In attempting to remedy the problem of overseas bribery, Congress enacted prohibitions that are riddled with ambiguity. Aggressive, albeit sporadic enforcement by the Justice Department and the SEC has further clouded the issue of what conduct is proscribed by the FCPA's antibribery provision.

The FCPA's accounting provisions have met with a similar fate. In attempting to curtail the falsification of accounting records, Congress imposed a somewhat ambiguous standard. The lack of clarity regarding the level of accounting accuracy required under the FCPA has been a source of great consternation to many who have previously testified before this committee.

It is my intention that any amendments to the FCPA remedy the problems that presently exist with regard to that act's application. Any amendments should not be designed to emasculate the FCPA, nor should they reflect any sentiment that we condone overseas bribery. Rather any amendments must be designed to send a clear message to corporate America and our trading partners by internationalizing the American view that bribing government officials to obtain business is an unacceptable and illegal practice and therefore must be proscribed. Further, any amendments must serve the dual purposes of proscribing bribery and improving the competitive position of American business in global markets by providing some certainty with regard to those acts that are proscribed by law.

We have received testimony regarding amendments to the FCPA on two other occasions. On those occasions we heard a great deal of testimony suggesting modifications to the FCPA's "reason to know" standard and accounting standards as well as the inclusion of provisions requiring an intent to bribe and permitting a good faith defense. I am interested to learn if the witnesses still believe that a need exists to amend the FCPA and that the amendments contained in S. 430 accomplish this goal in an acceptable manner. I look forward to their testimony.

Thank you, Mr. Chairman.

Senator HEINZ. I think virtually all the members of this committee would subscribe to the kind words you have for Secretary Baldrige. I know I do.

Mr. Secretary, please proceed.

STATEMENT OF MALCOLM BALDRIGE, SECRETARY, DEPARTMENT OF COMMERCE

Mr. BALDRIGE. It's probably all downhill from here on, Mr. Chairman.

I thought that Senator Proxmire made an outstanding case for an antibribery law. We have the law. I hope I can make a case as to why that law—to be really effective—should be amended.

Lawyers involved with this area thrive on ambiguity. They raise whole families on ambiguities and send them to college and feed them. Businessmen do not thrive on ambiguities. They are fearful

of ambiguity. And this act is causing them trouble unless it's clarified.

[The complete prepared statement follows:]

TESTIMONY OF MALCOLM BALDRIGE
SECRETARY OF COMMERCE

CHAIRMAN HEINZ AND CHAIRMAN D'AMATO, I AM PLEASED TO BE HERE TODAY TO SUPPORT THE SUBCOMMITTEES' EFFORTS TO REFORM THE FOREIGN CORRUPT PRACTICES ACT. THE ADMINISTRATION SUPPORTED LEGISLATION TO CLARIFY THE ACT'S AMBIGUITIES IN THE 97TH AND 98TH CONGRESSES. REFORM OF THE ACT WAS ONCE AGAIN INCLUDED IN THE PRESIDENT'S TRADE POLICY ACTION PLAN OF LAST SEPTEMBER 23RD. WE ARE PLEASED THAT YOU ARE HOLDING THIS HEARING TO CONSIDER THESE NECESSARY AND LONG-OVERDUE CHANGES.

AS VARIOUS ADMINISTRATION WITNESSES HAVE STATED ON SEVERAL OCCASIONS IN THE LAST FIVE YEARS, WE STRONGLY SUPPORT THE GOALS OF THE ACT: BRIBERY AND CORRUPTION IN INTERNATIONAL BUSINESS ARE INHERENTLY WRONG AND WILL NOT BE TOLERATED BY THIS ADMINISTRATION. WE ARE PROUD, AS I AM SURE THE SUBCOMMITTEES ARE, THAT THE UNITED STATES HAS TAKEN THE LEAD IN ATTEMPTING TO ERADICATE THIS ABUSE.

AT THE SAME TIME, IT IS ALSO CLEAR FROM THE EXPERIENCE WE HAVE GAINED OVER THE EIGHT YEARS THE ACT HAS BEEN IN EFFECT THAT IT IS NOT AS CLEAR AS IT COULD BE. THE BUSINESS COMMUNITY HAS STATED REPEATEDLY THAT IT IS NOT SURE WHAT PRACTICES ARE PROHIBITED AND WHAT PRACTICES ARE PERMITTED UNDER THE ACT. THIS UNCERTAINTY HAS INCREASED THE COST OF CONDUCTING INTERNATIONAL BUSINESS. THESE COSTS, COMBINED WITH THE THREAT OF ADVERSE PUBLICITY THAT RESULTS FROM EVEN UNFOUNDED ALLEGATIONS OF VIOLATIONS OF THE ACT, HAVE CAUSED U.S. FIRMS TO BE OVERLY CAUTIOUS AND TO FOREGO LEGITIMATE BUSINESS. THIS PROBLEM IS PARTICULARLY SEVERE FOR SMALL AND MEDIUM-SIZED FIRMS WHO CAN NOT AFFORD TO HIRE WALL STREET LAW

FIRMS TO GUIDE THEM THROUGH THE COMPLEXITIES OF THE ACT. WITH U.S. FIRMS MEETING FIERCE COMPETITION IN THE INTERNATIONAL MARKET PLACE, WE CANNOT AFFORD TO PLACE NEEDLESS HURDLES IN THE WAY OF LEGITIMATE EXPORTS.

ENACTMENT OF S. 430 WOULD GO A LONG WAY TOWARD REMOVING THIS UNCERTAINTY. THE BILL CORRECTLY IDENTIFIES THE MOST SIGNIFICANT PROBLEMS AND PROVIDES WORKABLE ALTERNATIVES WHICH CLARIFY THE REQUIREMENTS OF THE ACT. MOREOVER, THE BILL MAKES THESE REFORMS WHILE LEAVING IN PLACE THE STRONG SANCTIONS AGAINST USING BRIBES TO OBTAIN BUSINESS IN FOREIGN COUNTRIES. THESE PROBLEMS ARE:

- THE IMPOSITION OF CRIMINAL LIABILITY ON A CORPORATION AND ITS OFFICERS IF THEY HAVE "REASON TO KNOW" THAT AN AGENT IS GOING TO MAKE A BRIBE;
- THE LACK OF CLARITY IN THE ACT OVER WHETHER IT PERMITS A CORPORATION TO MAKE SO-CALLED "GREASE" PAYMENTS; AND
- THE IMPOSITION OF UNNECESSARILY BURDENSOME AND COSTLY ACCOUNTING PROVISIONS.

"REASON TO KNOW" OF PAYMENTS BY AGENTS

THE PROVISION OF THE ACT WHICH HAS PROBABLY LED TO THE GREATEST AMOUNT OF UNCERTAINTY WITHIN THE BUSINESS COMMUNITY IS THE PROVISION DEALING WITH THE RESPONSIBILITY OF A CORPORATE OFFICER

FOR THE ACTS OF AN AGENT. THE ACT CURRENTLY IMPOSES CRIMINAL LIABILITY ON A CORPORATION AND ITS OFFICERS IF THEY KNOW OR HAVE "REASON TO KNOW" THAT A THIRD PARTY, SUCH AS AN AGENT, IS GOING TO BRIBE A FOREIGN OFFICIAL WITH FUNDS RECEIVED FROM THE CORPORATION. WHAT MAKES EXECUTIVES NERVOUS ABOUT THIS PHRASE IS THAT THEY HAVE NO IDEA WHEN THEY MIGHT BE FOUND TO HAVE "REASON TO KNOW" ABOUT A BRIBE PAID BY AN AGENT WITHOUT THEIR AUTHORIZATION. I DON'T KNOW, MANY LAWYERS DON'T KNOW, AND CERTAINLY MANY BUSINESSMEN DON'T KNOW. IN LIGHT OF THIS UNCERTAINTY, EXECUTIVES DECIDING WHETHER TO COMPETE IN FOREIGN MARKETS MUST CONSIDER THE POSSIBILITY THAT THEY COULD BE FOUND LIABLE BY THE SUBJECTIVE JUDGMENT OF A COURT, WITH 20-20 VISION IN HINDSIGHT, THAT THEY HAD "REASON TO KNOW" OF A PAYMENT.

MANY CORPORATIONS HAVE CHOSEN TO PLAY IT SAFE WITH THE NET RESULT OF FEWER U.S. EXPORTS. WHILE IT IS IMPOSSIBLE TO QUANTIFY THE NUMBER OF LOST EXPORTS AS A RESULT OF THIS UNCERTAINTY, IT IS UNDOUBTEDLY SUBSTANTIAL -- AND EVEN IF IT WERE ONLY A FEW, IT WOULD BE A FEW TOO MANY. THERE IS NO NEED TO USE AN AMBIGUOUS STANDARD LIKE "REASON TO KNOW" SINCE THE PURPOSE OF THE ACT CAN BE MET BY A MORE OBJECTIVE AND PREDICTABLE STANDARD, SUCH AS THE STANDARD USED IN S. 430. UNDER THE BILL, THE CORPORATION AND ITS OFFICERS WOULD BE HELD RESPONSIBLE FOR THE PAYMENT MADE BY AN AGENT IF THEY "DIRECT OR AUTHORIZE" THE PAYMENT, EITHER EXPRESSLY OR "BY COURSE OF CONDUCT."

DEFINING PERMISSIBLE PAYMENTS

ANOTHER UNCLEAR PROVISION IN THE ACT IS THE ONE WHICH EXEMPTS PAYMENTS TO AN EMPLOYEE OF A FOREIGN GOVERNMENT "WHOSE DUTIES ARE ESSENTIALLY MINISTERIAL OR CLERICAL." THIS PROVISION WAS ADDED TO THE ACT BECAUSE THE CONGRESS RECOGNIZED THAT CERTAIN TYPES OF "GREASE" PAYMENTS ARE CUSTOMARY AND EXPECTED IN CERTAIN COUNTRIES AND SHOULD NOT BE SUBJECT TO THE SANCTIONS AGAINST MAKING BRIBES TO WIN CONTRACTS. EXAMPLES OF SUCH PAYMENTS INCLUDE THOSE NEEDED TO GET SHIPMENTS THROUGH CUSTOMS, TO SECURE REQUIRED PERMITS, AND TO OBTAIN ADEQUATE POLICE PROTECTION.

NOTWITHSTANDING THE INTENT TO EXEMPT THEM FROM THE ACT, THE STANDARD USED TO GOVERN SUCH PAYMENTS REQUIRES A SUBJECTIVE DETERMINATION ABOUT WHETHER THE DUTIES OF THE EMPLOYEE ARE "ESSENTIALLY CLERICAL OR MINISTERIAL." IN PRACTICE, THIS PHRASE IS DIFFICULT TO INTERPRET. PART OF THE DIFFICULTY IS THAT IT TALKS ABOUT THE RELATIONSHIPS AND FUNCTIONS OF EMPLOYEES IN FOREIGN GOVERNMENTS WHICH MAY NOT BE FAMILIAR TO THE AMERICAN BUSINESS EXECUTIVE. AGAIN, THIS UNCERTAINTY HAS RESULTED IN LOST EXPORTS BECAUSE AMERICAN FIRMS, UNLIKE THEIR FOREIGN COMPETITORS, ARE HESITANT TO MAKE SUCH PAYMENTS BECAUSE OF THE POTENTIAL LIABILITY UNDER THE FOREIGN CORRUPT PRACTICES ACT.

THE ACT COULD PROVIDE BETTER GUIDANCE TO BUSINESSMEN BY REPLACING THE "MINISTERIAL OR CLERICAL" STANDARD WITH SPECIFIC TYPES OF PAYMENTS WHICH ARE PERMISSIBLE. IN THIS REGARD, THE APPROACH

TAKEN BY S. 430 PROVIDES MUCH BETTER GUIDANCE. IT SPECIFIES THE TYPES OF PAYMENTS WHICH ARE PERMISSIBLE BY FOCUSSING ON THE PURPOSE OF THE PAYMENT INSTEAD OF THE ON DUTIES OF THE EMPLOYEE.

S. 430 PROVIDES A CLEAR SIGNAL TO U.S. FIRMS THAT IF A PAYMENT IS INTENDED TO OBTAIN OR RETAIN BUSINESS, IT IS SUBJECT TO THE CRIMINAL PROSECUTION. ON THE OTHER HAND, S. 430 WOULD PERMIT ANY PAYMENT WHICH IS:

- LAWFUL UNDER LOCAL LAW;
- USED TO "SECURE THE PERFORMANCE OF A ROUTINE GOVERNMENTAL ACTION,"
- INTENDED AS A COURTESY OR TOKEN OF REGARD, OR
- ASSOCIATED WITH SELLING OR PURCHASING GOODS OR SERVICES, OR WITH CONTRACT PERFORMANCE.

THESE CLARIFICATIONS ARE THE SORT OF REFORMS WHICH SHOULD HELP U.S. EXECUTIVES UNDERSTAND WHAT THEIR OBLIGATIONS ARE UNDER THE LAW.

ACCOUNTING STANDARDS

A FINAL AREA I WOULD LIKE TO MENTION WHICH NEEDS CLARIFICATION CONCERNS THE ACT'S ACCOUNTING STANDARDS.

SECTION 102 OF THE ACT REQUIRES ALL PUBLIC COMPANIES TO MAINTAIN AN ACCURATE ACCOUNTING OF THE TRANSACTIONS AND DISPOSITIONS OF THEIR ASSETS. IT ALSO REQUIRES THESE COMPANIES TO MAINTAIN A SYSTEM OF INTERNAL ACCOUNTING CONTROLS TO ENSURE MANAGEMENT AWARENESS OF, AND CONSEQUENTLY, ACCOUNTABILITY FOR, ILLEGAL PAYMENTS.

THE GENERAL ACCOUNTING OFFICE ISSUED A REPORT ON THE EFFECT OF THE FOREIGN CORRUPT PRACTICES ACT ON AMERICAN BUSINESS IN MARCH, 1981. THIS REPORT NOTES HOW EXPENSIVE IT IS FOR A COMPANY TO COMPLY WITH THE ACT'S ACCOUNTING PROVISIONS. ALMOST A QUARTER OF THE CORPORATE RESPONDENTS SAID THAT ACCOUNTING AND AUDITING COSTS INCREASED BY OVER 35 PERCENT, WHILE OVER ONE-HALF ESTIMATED THAT COMPLIANCE HAD INCREASED COST BY 11 TO 35 PERCENT.

THESE ACCOUNTING PROVISIONS, WHICH WERE ADDED TO COMPLEMENT THE ANTIBRIBERY PROVISIONS OF THE ACT, AFFECT PUBLIC COMPANIES REGARDLESS OF WHETHER THEY ENGAGE IN INTERNATIONAL BUSINESS. COMPLIANCE WITH THESE PROVISIONS IS PARTICULARLY DIFFICULT SINCE THEIR INTERPRETATION IS UNCLEAR.

FOR EXAMPLE, BECAUSE OF THE WORDING OF THE PROVISION, IT IS NOT CLEAR WHETHER THE REQUIREMENT TO "KEEP BOOKS, RECORDS AND ACCOUNTS IN REASONABLE DETAIL" IS A SEPARATE OBLIGATION OR PART OF THE OBLIGATION TO MAINTAIN A SYSTEM OF INTERNAL ACCOUNTING CONTROLS. IT SHOULD BE A PART OF THE OVERALL OBLIGATION TO SET UP A SYSTEM OF INTERNAL ACCOUNTING CONTROLS. BECAUSE OF THE ACT'S WORDING,

HOWEVER, IT HAS LED CAUTIOUS MANAGERS TO KEEP UNNECESSARY RECORDS, THEREBY IMPOSING ADDITIONAL COSTS WHICH HURT THE COMPETITIVENESS OF U.S. EXPORTS.

IN ADDITION, THE ACT COULD BE IMPROVED BY CLARIFYING THAT CORPORATIONS WILL NOT INCUR CRIMINAL LIABILITY UNDER THE ACCOUNTING PROVISIONS ALONE, AND WILL NOT INCUR CIVIL LIABILITY IF THEY HAVE MADE GOODS FAITH EFFORTS TO COMPLY.

IN THIS REGARD, THE ACCOUNTING PROVISIONS IN S. 430 PROVIDE A MAJOR IMPROVEMENT TO THE CURRENT LAW AND SHOULD ENABLE CORPORATIONS TO MEET THE PURPOSE OF THE CURRENT PROVISIONS IN A MORE EFFICIENT MANNER.

MR. CHAIRMAN, THAT CONCLUDES MY STATEMENT. THE DEPARTMENT OF JUSTICE WILL SUGGEST A FEW MINOR REVISIONS TO THE BILL TO IMPROVE IT FROM A LAW ENFORCEMENT PERSPECTIVE. I WANT TO THANK THE SUBCOMMITTEES FOR TURNING THEIR ATTENTION TO THE IMPORTANT MATTER AND I URGE YOU TO REPORT S. 430 FAVORABLY.

Senator HEINZ. Mr. Secretary, thank you for your testimony. We are delighted to have the strong administration support for S. 430.

Does this still remain a high priority with the administration?

Mr. BALDRIGE. Absolutely. We have tried, as you know, over the past 3 or 4 years and the fact that we're back trying again means that we recognize the significance of this. We are losing business because of this.

Senator HEINZ. How serious is the drag imposed by the current provisions of the FCPA and the ambiguities and difficulties you described? How much of an effect is that having on the competitiveness of U.S. exports and what has its impact been on lost business?

INCREASED COSTS ONE-THIRD

Mr. BALDRIGE. It's very hard to be specific insofar as how many individual businesses have been hurt because a lot of them don't want to talk about it.

I can speak from firsthand knowledge of companies that I've talked to. If you take the accounting provision, my statement in there I believe is exactly correct. It's increased costs up to a third.

I was familiar with a company that had $1 million in accounting fees that they paid to one of the big eight accounting firms, and the year after this came in they paid $1,300,000. The $300,000 was not lifting up the price for anything except trying to comply with the accounting provisions. That's one way it hurts.

But I think the main problem is in the ambiguity of "have reason to know." That scares the heck out of any businessman. How is he going to get caught on that? He just flounders on that and his lawyers can't help him very much. That's why I think it's

very important to clear that language up with the language in this bill.

I have again known first hand of companies who have gotten out of a whole line of business simply because of these kinds of problems rather than to put up with possible "have reason to know" kinds of prosecutions. They've just sold the business and gotten out of it.

Senator HEINZ. Mr. Secretary, let me ask you about the "reason to know' provisions. It's my understanding that Mr. Keeney of the Justice Department is going to argue in his statement against the provision in S. 430 that would not hold a company liable for the unauthorized actions of its agents.

Is the administration, based on his testimony, opposed to this provision of the bill?

Mr. BALDRIGE. I hadn't heard that before. You think he will argue against what?

Senator HEINZ. Against the provision in the bill that would not hold a company liable for unauthorized actions of its agent. That would be in a situation where a company did not know and did not authorize directly or by a course of conduct authorize a bribe by an agent, a third party.

Mr. BALDRIGE. I haven't seen the Justice Department's testimony and I'd have to take a look at it before I answer that question.

Senator HEINZ. We need to know if that is the administration's position. You are the lead witness and the ranking witness from the administration, so we would appreciate a clarifying statement. This is on page 2 of his statement. It comes as a Justice Department recommendation.

Mr. BALDRIGE. I would have to get you that because I would really have to read it, Senator. It's too important just to give an offhand opinion on it.

[The following material was subsequently supplied for the record:]

The administration supports the provision in S. 430 which would establish a new standard for determining the liability of a corporation and its officers for the acts of an agent. The current standard, which imposes liability on the basis of "reason to know," is needlessly ambiguous and has created uncertainty about what it is intended to prohibit. The standard used in S. 430, which bases liability on a "direct or authorize" standard, is much more objective and predictable and would help remove this uncertainty.

The portion of the Justice statement commenting on the liability of agents does not relate to the "reason to know standard," which is set out in section 104(a)(3) of the current FCPA (also section 30A(a)(3)). This section imposes liability in a "principal" for the acts of an agent. Rather, the Justice statement relates to the basic antibribery provision of section 104(a) (also section 30A(a)). The first sentence of this section imposes liability on an "agent" for making a corrupt payment to obtain or retain business. S. 430 would amend the basic antibribery provision to delete "agent" from the list of individuals who are subject to the prohibition ("It shall be unlawful for any domestic concern * * *, or any officer, director, employee, or "agent" of such domestic concern * * *"). The Justice Department's recommendation that the Congress consider retaining "agent" within the scope of S. 430 is made in the context of the basic antibribery provision and of course does not affect the administration's position on the inappropriateness of the "reason to know" standard for determining the liability of a "principal" for the acts of an agent.

Senator HEINZ. Let me ask you another question. The bill proposes to define more clearly those payments which are not bribes but are customary facilitating payments, so-called grease pay-

ments. And the bill also proposes to define more clearly the standard by which corporate liability for acts of an agent is determined.

ADDRESS THE ACT'S AMBIGUITIES

Now do you think either of those changes, first, effectively address the act's ambiguities, or do both of those effectively address the ambiguities that are impeding legitimate export sales efforts of U.S. corporations abroad? Do they do that?

Mr. BALDRIGE. Yes; I think they are a distinct improvement. I don't know how you could ever get all the ambiguity out, but this is certainly a good step in the right direction.

Senator HEINZ. Do you think either of those provisions is going to weaken the enforcement of either the Justice Department or the Securities and Exchange Commission in halting, stopping, circumscribing bribery?

Mr. BALDRIGE. No, I do not.

Senator HEINZ. So you see no possibility that someone may slip something by us, and that there is no increase in likelihood of a violation going either undetected or unpunished?

Mr. BALDRIGE. I don't see much increase in likelihood. When you say there's no case where nobody could slip something by——

Senator HEINZ. Well, I mean as a result of these changes in the act.

Mr. BALDRIGE. No, I don't really think so, Senator. I think it helps clear it up.

Senator HEINZ. Let me ask you, in returning to the difficulties of American companies, another question. In many cases, particularly with small companies, there is a heavy reliance, necessarily so, on foreign agents, though there is little control over the foreign agent since the exporter represents only a fraction of the agent's total business.

How discouraging is it to a company to know that it can face criminal charges based on the explicitly unauthorized action of an agent?

Mr. BALDRIGE. Well, it's very discouraging. You get there again into the "have reason to know," and that's a very tenuous base on which to make any judgments in that area.

As you know, Senator, agents are used as one method of selling all over the world. Smaller companies rely on them. As a practical matter, if you put yourself in the position of an executive of a smaller company trying to get into some far away market, you don't have the resources to do more than make perhaps one or two preliminary trips, find out from your peers or from the local chamber or from whatever source you trust, the names of some potential agents, interview them, and then hire one. And then you try and do your duty as far as following this law by paying that particular agent no more than what the going market rate is. There really isn't any way to know what that chap does with the commission. For example, let's say it's a normal commission—it varies from place to place—but let's assume it's 5 percent. Once he gets the 5 percent you don't know what he's done with it. For the small businessman to face the "have reason to know" standard puts him in a very difficult position and discourages him from really trying.

Senator HEINZ. One other question before I yield to my colleague, Senator Proxmire.

In his testimony Mr. Keeney recommends that the provisions in the bill requiring binding opinions that enforcement guidelines from the Justice Department be removed from the bill. How important do you believe those provisions are? Should we retain them in the bill and how much reassurance can a businessman feel from an opinion from the Justice Department that they do not think that such and such an action is a violation when Justice adds to their opinion the words "but don't hold me to it?"

Mr. BALDRIGE. That's a problem, Senator. That's a problem for business if they can't get some kind of a ruling that they can stick with. There's no question about that.

Senator HEINZ. Is the administration, then, in conflict on this position, or is it the administration's position that the Justice Department is wrong?

Mr. BALDRIGE. Well, I haven't seen the Justice Department provisions so I'd like to come back after I've seen that and give you my opinion on that as well as the other matter we've talked about.

Senator HEINZ. Thank you.

Senator Proxmire.

Senator PROXMIRE. Mr. Secretary, in determining whether or not to modify the Foreign Corrupt Practices Act, it seems to me the first thing we should do is to see whether or not there is any evidence, any documented evidence, that the Foreign Corrupt Practices Act has limited, reduced, or adversely affected exports.

GROWTH IN EXPORTS DURING FIRST 3 YEARS OF FCPA

Now in the 3 years prior to the passage of the Foreign Corrupt Practices Act, 3 years prior, U.S. exports adjusted for inflation grew at the rate of 1.5 percent a year. In the 3 years immediately following the act, the time when you'd think if ever the act should have an effect, our exports in real terms grew at an annual rate of 11.3 percent.

From these figures, it doesn't look as though the FCPA had any of the dire effects on exports that you assert. In fact, if anything, you could say that were helped by its enactment.

Now since President Reagan came to office it's a different situation. U.S. exports declined at an annual rate of 2.5 percent.

Why would it not be fair to conclude that all this talk about the Foreign Corrupt Practices Act is just a smokescreen to divert attention away from the real cause of our export problems, which is the bloated value of the dollar, trade barriers, debtor nations unable to buy, and so forth, that have plagued us over the past few years?

Mr. BALDRIGE. I don't think you can put the whole rise and fall of the trade deficit or our ability to export on changing some provisions in the FCPA. We all want to have a FCPA. We are talking about clarifying it here, but nobody that I know has ever made the statement or charge that our whole export effort depends on it.

That's a common misunderstanding, Senator, if I may say so. When you look at any individual item that affects productivity or competition or competitiveness, it's never the whole answer. It's part of a mosaic of competitiveness. It's like some of the things

we're trying to do in antitrust. I hear people say, well, that's not the reason for having a trade deficit; it's the high dollar or something. Well, of course, that's true. It's all part of the mosaic of competitiveness. There's just no one competitiveness handle which if you pull up hard enough all of a sudden makes us competitive worldwide. It's a series of smaller things.

Senator PROXMIRE. Well, I acknowledge that, but I put into the record the documentation by Dr. John Graham of the University of Southern California and he studied the problem over a period of time. He concluded that the Foreign Corrupt Practices Act had not been a disincentive to American exports. He analyzed published trade statistics and other Government reports in coming to that conclusion.

Now you contend on page 3 of your testimony that because of certain ambiguities in FCPA, "many corporations have chosen to play it safe with a net result of fewer exports."

My question is, do you have any studies that dispute Dr. Graham's analyses and back up your assertion that exports are being lost because of FCPA? If you do not have any reputable studies, can you provide us with any concrete examples of instances where exports have been hindered by the present law?

RESEARCH REPORT BY U.S. CHAMBER OF COMMERCE

Mr. BALDRIGE. Yes, we do. For example, here is a research report, "The Price of Ambiguity, More Than 3 years Under the Foreign Corrupt Practices Act," by Weisberg and Rickenberg, international division, Chamber of Commerce, United States of America. They made a study of specific cases and if you don't have that for the record I believe you should and I would be glad to put it in.

Senator PROXMIRE. We don't have it for the record and I'd very much like to see it.

[The report from the U.S. Chamber of Commerce may be found of p. 186.]

Mr. BALDRIGE. And this does get specific. Now a lot of the companies, for obvious reasons, didn't want their names mentioned, but the report includes specific examples.

Also, GAO made a study in 1981 which I will send that in for the record too. That explains how the cost has gone up and how this has hurt our exports.

Senator PROXMIRE. I think you can understand why the International Chamber of Commerce—it's a fine organization and certainly has my respect—nevertheless, it's an organization that has some degree of bias under these circumstances and a study by a distinguished scholar might be regarded as somewhat more objective.

Mr. BALDRIGE. Well, I don't know the individual scholar that you're talking about, Senator, so I can't really compare the two. But not all scholars are above having a, let's say, a slight bias.

Senator PROXMIRE. On pages 4 and 5 of your testimony you praise S. 430 for replacing the grease payment exceptions in the present law with specific types of payments which are permissible. You list five exceptions to the prohibition on bribery found in S. 430 and state, "These are the sort of reforms which would help

U.S. executives understand what their oblilgations are under the law."

I think you're absolutely right. If some of those exceptions were passed, U.S. executives would understand they have no obligations under the FCPA. Let me take exception 1 as an example. It makes legal "any facilitating or expediting payment to a foreign official the purpose of which is to expedite or secure the performance of a routine governmental action by a foreign official." You can make any payment if that's what you say the payment is for.

So can't the awarding of contracts be a routine governmental action by some official? Isn't that provision a wide open loophole? Can you explain what type of payment it would and would not permit.

GREASE PAYMENTS

Mr. BALDRIGE. Well, that covers the waterfront, Senator. What you run into is in some countries you just won't get something important moved through customs unless you tip the customs official there. I know of countries where you cannot either get the telephone hookup in your office building without making what's called a grease payment. In that same country, if you have the phone put in maybe after a lot of heat and struggle and so forth, you don't get good telephone service when your competitor in an office just down the hall does get good telephone service. There are a multitude of ways that other governments allow their employees to extract what you might call facilitating or grease payments.

Senator PROXMIRE. Well, grease payments are permitted under present law.

Mr. BALDRIGE. Yes; but they are defined as given to an employee whose duties are essentially ministerial or clerical and you can't find out who that is in too many cases. So what the bill is trying to do is to pin it down for the reasons. So if you can say, "Well, I couldn't get my telephone service in unless I did this," that's something everybody can understand.

Senator PROXMIRE. Well, if you confine it to telephone service or customs, that would be fine. But we don't do that. We say "to a foreign official to expedite or secure the performance of a routine governmental action by a foreign official."

I would think that virtually any kind of action by the foreign official would fall into that category.

Mr. BALDRIGE. In some countries, Senator, as you know, there aren't any really private businessmen. The businesses are all run by the government. They are government-owned businesses and you must deal with either the ministers or somebody in the ministerial department down the line who may not be of a high rank, but if you want to get something done in a case of either getting your facilities set up or just conducting normal business like getting a paper stamped so you can go and get an import quote or something, frequently those people will hold you up unless you have a facilitating payment. And I think that's for two reasons. One is some of those countries literally underpay the people working for them because they expect them to make it up this way, and

in other areas. It's not looked on as immoral in these countries. That's something that some Americans don't understand.

Senator PROXMIRE. Let me ask you this. Let's take exception 3. It makes legal "any payment, gift, offer or promise of anything of value which constitutes a courtesy, a token of regard or esteem, or in return for hospitality."

Couldn't I make a $10,000 payment under that provision to some official who awards contracts and claim it was not a bribe; it was rather a token of my esteem? That's pretty wide open. Or it could be, if it were a prime minister, maybe $50,000 or maybe $100,000, a token of my esteem.

Mr. BALDRIGE. No; I would not interpret it that way, Senator. I think that goes far beyond a facilitating payment.

Senator PROXMIRE. Well, you might not, but it seems to me a court would be bound to do so. The exception says, "a token of my esteem." After all, if you have esteem for somebody, and it says a payment, it doesn't say a gift, it would be hard cash—if you esteem somebody you don't insult him by giving him a couple of thousand bucks, you make it big. He's a big man and you show you have real big esteem for him.

Mr. BALDRIGE. Well, I don't think that $10,000 is envisioned in this at all. Facilitating payments are much less than that.

Senator PROXMIRE. Do you want to put a limit on that, knock it down to $1,000?

Mr. BALDRIGE. That's part of the difficulty of this act. I wish I was smart enough to know exactly how to get that because it's a dichotomy.

Senator PROXMIRE. That's why I think the act is working pretty well now. There's no documentation that FCPA as written has cut our exports.

Let me ask you this one, take the exception "for any expenditure including travel and lodging expenses associated with the selling or purchasing of goods or services or with a demonstration or explanation of products." Now if I have to pay an agent an extra high commission because he bribes, isn't that high commission an expenditure associated with selling?

Mr. BALDRIGE. I don't know of any place where under this law where a businessman would feel that he could legally pay an extra high commission because the chap would use it for bribing purposes. I think the common case is just the reverse, where you try and figure out in a foreign country what is a normal commission for the particular kind of product that you're selling—and they do vary—there's a difference between airplanes and home appliances. But if you pay the normal commission, you should be able to feel that you are doing the right thing. If you pay a very high commission, you should have a suspicion about what's going to happen to it. I think that's the nub of the problem.

LOOPHOLES LARGE ENOUGH TO DRIVE A TRUCK THROUGH

Senator PROXMIRE. Let me just say that the testimony on the House side by a distinguished lawyer who has studied this very carefully said that these are loopholes big enough to drive a truck

through. The New York Times editorialized that it's a loophole big enough to fly Lockheed through.

Mr. BALDRIGE. Well, it's not big enough to fly Lockheed through.

Senator PROXMIRE. A truck then.

Mr. BALDRIGE. Your point about Tanaka and the trouble there in Japan is I think adequately covered in the bill. I think it's an exaggeration to take those huge examples and put them down on the level of a small- or medium-sized businessman just trying to get along—he's not trying to bribe anybody—but if he is so afraid of "have reason to know" that he's not even going to try, we're the losers; we all are. And I do not think we are talking about $10,000 payments or that it would be interpreted that way legally, and I don't think that's a loophole big enough to drive a truck through.

If you pay a standard commission—here's the problem of the small- or medium-sized manufacturer or even the large one—if you pay a standard commission to somebody in a country that is not higher than the average, how are you going to check up on what that agent does with it, whether he uses it at his country club or sends his kid to college or donates to a political party? That's the way a lot of them are done. And I don't see how a U.S. citizen can be held that strictly accountable. Now if they really know, that's one thing. But to "have reason to know" and then you take an agent in a place and pay him the standard commission and he puts in maybe 10 percent of that commission to the political party of his choice, well, maybe there happens to be only one political party in that country. Right away, under this "have reason to know," I think he's in real trouble and I don't think he should be.

Senator PROXMIRE. My time is up. Thank you very much, Mr. Secretary. I have to go to the floor. I will be back in a few minutes.

Senator HEINZ. Before I yield to Senator Hecht for questions, I want to recognize Senators Mattingly and Sasser for any opening remarks they may wish to make.

Senator SASSER. Mr. Chairman, I do have an opening statement.

Senator HEINZ. Without objection, so ordered.

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. I think a major contribution was made to long-term public confidence in our business sector when the Foreign Corrupt Practices Act was passed in 1977. American investors and taxpayers alike are well served by a statute that promotes thorough accounting procedures, and promotes American standards of ethical conduct in the world marketplace. And, in fact, American business is well served by a reputation for fair dealing. That reputation reflects well on us as a nation.

The law has been in effect now for 8 years. Although the bill before us has been before the Senate twice before, I think each passing year of experience with the current statute is instructive. We have 3 more years of history to review this morning, hearing from the regulators who administer and enforce the FCPA, the corporations operating under it, and legal opinions about it.

I think changes in this statute are necessary. It is obvious even at first glance that several provisions are highly ambiguous. If American business operated solely inside the borders of the United

States, the issues would be easier to define. But they do not. Traditions and practices abroad are, in a word, different. Lines of demarcation, within and between the public and private sectors in foreign countries, are not drawn the way they are in the United States.

It is obvious at one extreme that a large, undocumented payment to a senior policy official of a foreign government for the express purpose of winning a contract is not something the American people want their Government to condone. And it is obvious that payments of routine transaction fees to expedite routine services are the accepted mode of doing business in many countries. No one is well served by crippling the ability of American business to function effectively in foreign lands.

The problems arise in the many areas between those two extremes. Clarification of the ambiguities in the Foreign Corrupt Practices Act is not going to be a simple matter. Congress has been deadlocked for years, and I think that's a reflection of the difficulties involved.

Our witnesses this morning have a great deal to offer in the way of constructive suggestions, based on their real-world experience with the FCPA, for making needed changes. I look forward to their advice and good counsel.

And I'm going to have to follow Senator Proxmire to the floor, but I do applaud you for having this hearing today and I look forward to reading the record and having the benefit of the Secretary's views as well as those of the other witnesses.

Senator HEINZ. Senator Sasser, thank you very much.

Senator Mattingly.

REMARKS OF SENATOR MATTINGLY

Senator MATTINGLY. Thank you, Mr. Chairman. I just want to commend you and Senator D'Amato for introducing this piece of legislation. I think it's not only needed now but it was probably needed several years ago.

I do have a statement for the record, but I think that everybody has got to agree that the current law is a disincentive for anybody who wants to export from the United States overseas. We've got a law that's loaded with ambiguities and we've got a law that's loaded with unfairness and discouragement, especially for the small businessman.

If you look at the law through the eyes of a small businessman, you probably would give up wanting to trade overseas. The small businessman simply can't afford to abide by that law. I just jotted down here some points after listening to Senator Proxmire talk about people accused of corrupt action or knowledge. Yes, we've got laws to handle people that pursue illegal acts, but the laws sure don't help people who are trying to abide by the law, and I think this is very detrimental. I have spent a good deal of my time on this committee attempting to create a positive atmosphere for small business people in our country because I feel—and I think you do, too—the small businessman can really make a difference in exports. He can really make a difference in the balance of trade.

I think this bill, S. 430, goes a long way toward accomplishing that goal and I hope it doesn't end up the same way the identical bills, S. 708 and S. 414, went. We hear a lot of yelling and screaming and hollering up here on Capitol Hill, especially in the House, about great pieces of trade legislation they want to enact. Well, one thing that could really be of value would be the passage of S. 430.

Thank you, Mr. Chairman.

[The complete prepared statement follows:]

STATEMENT OF SENATOR MACK MATTINGLY

I would like to commend the Senator from Pennsylvania, Senator Heinz and the Senator from New York, Senator D'Amato for holding this hearing today. S. 430, a bill to amend the Foreign Corrupt Practices Act of 1977, is legislation vital to this country's export health.

The 1977 act was a historic effort; never before had American law attempted to address the bribery of foreign officials that adds to the cost of Americans doing business overseas. Yet this first attempt to regulate these practices has, in varying degrees, itself become a disincentive for U.S. exporters. Of particular concern to me is the 1977 act's effect on small business exporters, both existing and future. I think that nowhere are the ambiguities in the existing law more clear than when seen through the perspective of a small businessman attempting to establish an export market. It is then that the costs of the law as written become painfully apparent—a small businessman cannot afford, in many cases, the required separate accounting procedures or to monitor, with certainty, the activities of the necessary foreign agents. I have spent a good deal of my time as a member of this committee attempting to ensure a positive environment for small business exporters. The small businessman can make a difference in our export performance. We must continue to provide the type of business climate that will attract small, as well as larger, exporters. This includes eliminating unnecessary disincentives in U.S. laws regulating overseas commerce. S. 430 goes a long way toward accomplishing the original intent of the 1977 act clearly and efficiently.

Let me close by reminding those here today that S. 430 is identical to S. 708, which passed the Senate in 1981, and S. 414, which was reported in 1983 by the full Banking Committee. S. 430 is a vital part of S. 1860, the Bipartisan Trade Enhancement Act. I hope that, on our third try, the Congress can at last act to eliminate a festering disincentive to U.S. exporters. I understand that the administration remains supportive of our efforts in this regard, but would like to suggest some technical refinements. I look forward to hearing testimony from all of today's witnesses. Thank you.

Senator HEINZ. Senator Mattingly, thank you very much.

Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman. I don't have any questions. I want to hear the other witnesses. But I, too, want to commend you on these hearings. I think they are very timely. We need them and it's long overdue.

Senator HEINZ. Senator Hecht, thank you very much.

Secretary Baldrige, thank you very much for your testimony. You've done your usual excellent job and I appreciate your responses to the numerous questions that you received. They were all very articulate.

Mr. BALDRIGE. Thank you, Mr. Chairman.

Senator HEINZ. We look forward to receiving your comments on those two questions on Mr. Keeney's testimony.

Mr. BALDRIGE. Yes.

Senator HEINZ. At this time the Chair would call Edward H. Fleischman, Commissioner of the Securities and Exchange Commission; and John C. Keeney, Deputy Assistant Attorney General of the Criminal Division of the Department of Justice.

I would like to ask Mr. Fleischman to start off.

STATEMENT OF EDWARD H. FLEISCHMAN, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. FLEISCHMAN. Chairman Heinz and members of the Subcommittee: the Securities and Exchange Commission appreciates this opportunity to express its support for S. 430. The Commission has submitted a formal statement for the record. May I summarize the Commission's views?

BENEFITS ACCRUING FROM S. 430

As you know, the Commission previously supported two predecessor bills which proposed similar amendments to the Foreign Corrupt Practices Act. Like those bills, S. 430 provides greater certainty for persons subject to the act and reduces compliance costs that are not necessary to accomplish the statutory objectives.

S. 430 would incorporate the recordkeeping requirements within the objectives of the internal accounting control provisions and thus would continue to hold management responsible for providing reasonable assurances that corporate transactions are recorded accurately and in reasonable detail.

Assurances would be reasonable if they would satisfy prudent individuals in the conduct of their own affairs on a cost-effective basis.

S. 430 would also prohibit the knowing circumvention of an internal accounting controls system, including deliberate falsification of books and records, but would make it clear that no criminal liability would result solely from failure to comply with the internal accounting control requirements.

These and other related amendments in S. 430 would generally codify the Commission's policy statement on the Foreign Corrupt Practices Act.

The Commission's primary mission is to protect investors through full disclosure. Prior to enactment of the FCPA, the Commission suggested that the prohibition of foreign bribery raised important issues of national policy unrelated to the objectives of the securities law. Because the Commission's primary mission is disclosure, rather than substantive regulation of day-to-day commercial transactions, the proposed amendment to consolidate the antibribery enforcement responsibilities within the Department of Justice would not impair the Commission's ability to administer the securities laws. In instances where foreign bribery involves the failure to disclose material information, the Commission would retain its authority to take appropriate action.

With respect to the substance of the antibribery amendments, the Commission defers to the other agencies testifying before the subcommittees today.

While the legislative process may result in further refinements, S. 430 is a constructive and responsible measure.

For the foregoing reasons, the Commission supports S. 430.

Thank you, Mr. Chairman.

[The complete prepared statement follows:]

STATEMENT OF THE HONORABLE EDWARD H. FLEISCHMAN,
COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION,
BEFORE JOINT HEARINGS OF THE SUBCOMMITTEE ON
SECURITIES AND THE SUBCOMMITTEE ON INTERNATIONAL
FINANCE AND MONETARY POLICY OF THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

CONCERNING S. 430,
TO AMEND THE FOREIGN CORRUPT PRACTICES ACT OF 1977

June 10, 1986

I. Introduction

The Securities and Exchange Commission appreciates the opportunity to participate in these hearings concerning S. 430, the Business Accounting and Foreign Trade Simplification Act. The Commission previously supported two predecessor bills which proposed similar amendments to the Foreign Corrupt Practices Act of 1977 ("FCPA"). 1/ Like those bills, S. 430 would clarify the law without jeopardizing the objectives of the FCPA.

In its prior testimony, the Commission indicated that the FCPA had "generated a substantial degree of consternation among

1/ See Statement of the Honorable John S.R. Shad, Chairman, Securities and Exchange Commission, before Joint Hearings of the Subcommittee on Securities and the Subcommittee on International Finance and Monetary Policy of the Senate Committee on Banking, Housing and Urban Affairs concerning S. 414 (February 24, 1983)(hereinafter "1983 Testimony"); Statement of the Honorable John S.R. Shad, Chairman, Securities and Exchange Commission, before Joint Hearings of the Subcommittee on Securities and the Subcommittee on International Finance and Monetary Policy of the Senate Committee on Banking, Housing and Urban Affairs concerning S. 708 (June 16, 1981)(hereinafter "1981 Testimony").

business men of utmost good faith." 2/ Many commentators had expressed concerns that the accounting provisions of the Act expose persons to Commission enforcement action, or perhaps criminal liability, based on technical or insignificant errors in corporate records or weaknesses in corporate internal accounting controls.

The Commission also noted in its prior testimony that, in response to such concerns, the Commission has provided guidance concerning its interpretation of the accounting provisions. 3/ Among other things, the Commission in 1981 issued a Statement of Policy expressing its view that the accounting provisions do not mandate absolute exactitude in recordkeeping or an ideal system of internal accounting controls. Instead, the Commission

2/ 1983 Testimony at 1; 1981 Testimony at 5. See also Securities Exchange Act Release No. 17500 (Jan. 29, 1981), 46 F.R. 11544 (Feb. 9, 1981), 21 SEC Docket 1466 (Feb. 10, 1981) (hereinafter "Commission Policy Statement").

3/ Commission Policy Statement, 21 SEC Docket 1466. See also Securities Exchange Act Release No. 15570 (Feb. 15, 1979), 44 F.R. 10964 (Feb. 23, 1979), 16 SEC Docket 1143 (Mar. 6, 1979); Securities Exchange Act Release No. 15772 (Apr. 30, 1979), 44 F.R. 26702 (May 4, 1979), 17 SEC Docket 421 (May 15, 1979); Securities Exchange Act Release No. 16877 (June 6, 1980), 45 F.R. 10134 (June 13, 1980), 20 SEC Docket 310 (June 24, 1980).

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recognized that the provisions are limited by a concept of reasonableness that tolerates certain deviations from the ideal and contemplates a cost-benefit analysis. 4/ The Commission also stated that the principal purpose of the accounting provisions is to reach knowing or reckless conduct.

In its enforcement efforts under the accounting provisions of the FCPA, the Commission has adhered to its 1981 Statement of Policy. The cases have not involved insignificant or technical infractions, nor have individuals been charged with inadvertent conduct. The proposed amendments would generally codify the Commission's Statement of Policy, and we support the bill.

II. The Accounting Provisions

The accounting provisions of the FCPA, which are contained in Section 13(b)(2) of the Securities Exchange Act of 1934, require issuers: (a) "to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;" and (b) "to devise and maintain a system of internal accounting

4/ The Commission also supported the Justice Department's efforts to afford guidance concerning the bribery provisions. See Securities Exchange Act Release No. 18255 (Nov. 12, 1981), 46 F.R. 56692 (Nov. 18, 1981), 23 SEC Docket 1482 (Nov. 24, 1981); Securities Exchange Act Release No. 17099 (Aug. 28, 1980), 45 F.R. 59001 (Sept. 5, 1980), 20 SEC Docket 1258 (Sept. 16, 1980).

controls sufficient to provide reasonable assurances" that certain statutory objectives are met. 5/

A. Accounting Provision Amendments

Amendments to the accounting provisions should accomplish two goals in addition to ensuring that the statutory objectives of the FCPA are met. First, they should provide greater certainty so that persons subject to the Act know what it permits and what it prohibits. Second, amendments should reduce compliance requirements that are not necessary to the accomplishment of the

5/ These objectives are reasonable assurances that:

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

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statutory objectives. While there may be a variety of ways to achieve these goals, analysis of S. 430 indicates that this bill addresses the relevant concerns.

1. Elimination of Separate Recordkeeping Provision

The legislative history of the FCPA shows that the books and records provisions and the internal controls provision were intended to be coordinate. S. 430 would clarify this intention by eliminating the existing requirement that reporting companies "make and keep records which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." That recordkeeping requirement has been controversial because it raises the possibility of an enforcement action based solely on the existence of a single inaccurate accounting record.

S. 430 would continue to hold management responsible for providing reasonable assurances that corporate transactions are recorded accurately and in reasonable detail. This is because the bill would amend the statute to provide that reasonably accurate and detailed books and records are one of the objectives of internal accounting controls. 6/ Moreover, S. 430 would prohibit the knowing circumvention of a system of internal

6/ Compare Statement on Auditing Standards No. 1., Section 320.38: "The objective of accounting control with respect to the recording of transactions requires that they be recorded at the amounts and in the accounting periods in which they were executed and be classified in appropriate accounts."

accounting controls. This would include the deliberate falsification of books and records or other conduct calculated to evade the internal accounting controls requirement.

2. Addition of Prudent Person Standard

S. 430 would further clarify the FCPA by adopting the Commission's prior recommendation that "reasonable assurances" be defined as those that would "satisfy prudent individuals in the conduct of their own affairs, having in mind a comparison between benefits to be obtained and costs to be incurred in obtaining such benefits." 7/

The prudent person standard is new. It would provide a benchmark for assessing the reasonableness of management judgments concerning systems of internal accounting controls.

The cost-benefit test is presently contained in the legislative history of the FCPA, but is not set forth in the statute. The test is consistent with the auditing standard which recognizes that "the cost of internal control should not exceed the benefits expected to be derived." 8/ The auditing standard also recognizes that "[t]he benefits consist of reductions in the risk of failing to achieve the objectives implicit in the definition of accounting control." 9/

7/ 1983 Testimony at 6; 1981 Testimony at 10-12.

8/ Statement on Auditing Standards No. 1, Section 320.32.

9/ Id.

3. Other Revisions

The proposed legislation would also provide that no criminal liability will result solely from failure to comply with the accounting provisions. If a violation of the internal accounting controls requirement should be associated with criminal violations of other provisions of the securities laws, such as the antifraud provisions, a criminal prosecution could be brought on the basis of those other provisions.

Further, the bill would make clear that no civil injunctive relief may be imposed with respect to an issuer for failing to comply with the accounting provisions "if such issuer shall show that it acted in good faith in attempting to comply with such requirements." This is not inconsistent with the Commission's prior testimony to the effect that it is inappropriate to hold a corporation liable for recordkeeping or internal accounting controls violations by low or middle level employees, in the absence of involvement by senior officials. 10/ Since an issuer's attempt to comply with the law should be reasonable as well as bona fide, the term "good faith" should be understood to include reasonableness.

10/ 1983 Testimony at 7; 1981 Testimony at 15-18.

Persons other than an issuer would be subject to civil injunctions only if they knowingly cause an issuer to fail to devise or maintain an adequate system of internal accounting controls or knowingly circumvent such a system. While this amendment has no counterpart in the present law, it too is consistent with the Commission's prior testimony. 11/

In addition, the proposed legislation would clarify the extent to which an issuer may be held responsible for FCPA accounting violations by a subsidiary when it holds 50 percent or less of the voting power of the subsidiary. The bill would require that the issuer proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause its subsidiary to comply with the internal accounting controls requirement. This provision is also consistent with the Commission's prior testimony. 12/

B. The Commission's Enforcement of the Accounting Provisions

Since the FCPA was enacted in 1977, the Commission has brought 73 actions to enforce the accounting provisions of the statute and the rules adopted by the Commission thereunder. 13/

11/ 1983 Testimony at 8; 1981 Testimony at 3.

12/ 1983 Testimony at 8; 1981 Testimony at 14-15.

13/ The Commission adopted two rules, Rules 13b2-1 and 13b2-2, following the enactment of the FCPA. Rule 13b2-1 prohibits any person from falsifying corporate records, and Rule 13b2-2 prohibits corporate officers, directors and shareholders from misleading accountants in connection with an examination of an issuer's financial statements.

These actions include 65 injunctive suits and eight administrative proceedings.

Violations of the accounting provisions have all been uncovered in connection with inquiries into other possible violations of the securities laws. Each of the injunctive suits has involved allegations that the corporate defendant violated one or more disclosure requirements administered by the Commission, which include the antifraud provisions contained in Section 10(b) of the Securities Exchange Act, the reporting requirements set forth in Sections 13(a) and 15(d), and the proxy provisions contained in Section 14(a) of the Act, and applicable rules. Thus, each injunctive suit could have been prosecuted without reference to the FCPA accounting provisions. By virtue of settlements reached in three of the eight administrative proceedings (based, like all settlements, on the particular circumstances of each case), 14/ those proceedings referred solely to the accounting provisions.

The sole judicial interpretation clarifying the accounting provisions sustained the Commission's allegations that the

14/ In the Matter of Telex Corporation (Admin. Proceeding File No. 3-6123, Securities Exchange Act Release No. 18694, commenced Apr. 29, 1982); In the Matter of Government Securities Management Company, Inc. (Admin. Proceeding File No. 3-6153, Investment Advisers Act Release No. 814, commenced July 21, 1982); In the Matter of Tonka Corporation (Admin. Proceeding File No. 3-6561, Securities Exchange Act Release No. 22448, commenced Sept. 24, 1985).

issuer, aided and abetted by two of its officers, had violated those provisions (in addition to antifraud and disclosure provisions). 15/

The 73 cases brought to enforce the accounting provisions have involved improper accounting with respect to four broad categories of conduct: (a) questionable or illegal payments; (b) exaggeration of company sales and assets, or the failure to keep adequate records of business transactions; (c) misappropriation or diversion of corporate assets in cases that have not involved questionable or illegal payments; and (d) unauthorized management perquisites. 16/ Except for the three administrative proceedings already noted, all these actions also cited other sections of the Securities Exchange Act, and all could have been brought and sustained without reference to Section 13(b)(2) added by the FCPA. The Commission could not

15/ SEC v. World-Wide Coin Investments, Ltd., 567 F. Supp. 724 (N.D. Ga. 1983). One of the defendants was subsequently convicted and sentenced to five years imprisonment plus a $60,000 fine. U.S. v. Hale, CR-84-253-A (N.D. Ga.). See Litigation Release No. 10668 (Feb. 12, 1985), 32 SEC Docket 820 (Feb. 26, 1985).

16/ There has been one criminal prosecution in which the only alleged securities law violation involved Rule 13b2-2 (prohibiting officers and directors from making false statements to accountants in connection with an examination of an issuer's financial statements). The defendant in that action was also charged with mail fraud and with filing false tax returns. See U.S. v. Scharff, CR84-76 (N.D. Ohio); Litigation Release No. 10342 (Apr. 13, 1984), 30 SEC Docket 479 (May 1, 1984).

proceed directly against issuers for inaccurate books and records or inadequate corporate controls without the accounting provisions of the FCPA, and cases could arise in which no material nondisclosure is alleged and where these provisions would provide the only basis for an enforcement action. Nevertheless, with or without the accounting provisions of the FCPA, the Commission has the ability to discharge its traditional responsibility for enforcing full disclosure of material information to the investing public. 17/

III. The Anti-Bribery Provisions

The FCPA also charges the Commission with responsibility for civil enforcement of the prohibition of bribery of foreign officials by issuers. That prohibition is contained in Section 30A of the Securities Exchange Act. To date, the Commission has brought two enforcement actions under Section 30A, 18/ both of which also alleged antifraud and disclosure violations.

17/ Enactment of S. 430 would not appear to affect the validity of the Commission's Rules 13b2-1 and 13b2-2.

18/ SEC v. Katy Industries, et al. (N.D. Ill., Civil Action No. 78C-3476, commenced Aug. 30, 1978); SEC v. Sam P. Wallace, Inc., et al. (D.D.C., Civil Action No. 81-1915, commenced Aug. 13, 1981).

The Commission's primary mission is to protect investors through full disclosure. The Commission made it clear, prior to enactment of the FCPA, that the prohibition of foreign bribery raised important issues of national policy unrelated to the objectives of the securities laws. Former Commission Chairman Roderick M. Hills recommended to the Senate Banking Committee that, if Congress chose to outlaw such transactions, it should not do so under the securities laws. 19/ Congress decided, however, to assign responsibility for civil enforcement of the prohibitions applicable to publicly-held companies to the Commission. Civil enforcement of the prohibitions applicable to privately-held companies, and all criminal enforcement, were assigned to the Justice Department.

Because the Commission's primary mission is disclosure, not substantive regulation of day-to-day commercial transactions, repeal of Section 30A would not impair the Commission's ability to administer the securities laws. In instances where foreign bribery involves a failure to disclose material information, the Commission would retain its authority to take appropriate action. For these reasons, the Commission supports the proposed amendment, which would transfer all enforcement authority with

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19/ Testimony of Roderick M. Hills, Chairman, Securities and Exchange Commission, Before the Senate Committee on Banking, Housing, and Urban Affairs, p. 9 (March 16, 1977).

respect to Section 30A to the Department of Justice. In addition, consistent with its prior testimony, the Commission defers to the other agencies testifying before these Subcommittees with respect to the substance of the proposed amendments to the anti-bribery provisions.

IV. Conclusion

While the legislative process may result in further refinements of the proposed legislation, the bill as introduced is a constructive and responsible measure. The Commission has endeavored to administer the FCPA in a reasonable and responsible manner. The enactment of S. 430 would amend the law in a manner generally consistent with the Commission's existing policies and practices. Accordingly, the Commission is pleased to support the bill.

Senator HEINZ. Mr. Fleischman, thank you very much. Mr. Keeney.

STATEMENT OF JOHN C. KEENEY, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE

Mr. KEENEY. Thank you, Mr. Chairman. I'd like to offer in evidence my complete statement and then, if I may, just hit a few highlights of the statement.

Senator HEINZ. Without objection, your entire statement will be part of the record.

Mr. KEENEY. What we've tried to do here, Mr. Chairman, in our analysis of your bill, S. 430, is to make constructive suggestions where from the viewpoint of law enforcement the bill could be more effective.

Let me just go down a few of these items that we have in mind.

LIABILITY OF AGENTS

On the liability of agents, we recommend that the Congress consider retaining agents specifically within the scope of S. 430. To eliminate them from coverage would decrease the act's effectiveness in our view. The majority of the FCPA cases which have been investigated involve payments made to agents.

Senator HEINZ. May I clarify what you're saying? You're saying that if an agent corruptly bribes a foreign official that the company should be liable for that irrespective of "reason to know?"

Mr. KEENEY. Well, with respect to reason to know, we are suggesting in my statement that we can live without reason to know, Senator. With respect to your question, we would like agents kept in there so that we can prosecute agents as well as the corporations

where the agent is acting for and on behalf of the corporation. We think that taking it out—it's presently in the statute—taking it out is a signal to the courts that for some reason or other that the Congress doesn't want agents prosecuted and that's our only point, Senator.

Senator HEINZ. So your sole concern is with the ability to prosecute agents?

Mr. KEENEY. Yes, sir; because agents have played such a prominent role in the cases that we've investigated under the act. Many of these agents were nationals of the foreign country whose officials were to be bribed. Others were American citizens residing either in the foreign country or in the United States.

With respect to reason to know, the present FCPA prohibits payments by U.S. businesses or individuals to a third party if the payor knows or has reason to know that all or part of those payments will be given by that third party to a foreign official.

The revised section 104(b) set out in S. 430 would eliminate the "reason to know" language while retaining in amended form the remainder of the prohibition. The reason to know standard, Senator, has never been used to prosecute anyone. The policy of the Department has been to prosecute only those cases where the evidence of awareness, whether direct or circumstantial, was so clear as to constitute actual knowledge of the bribe scheme. The policy would not be changed by abolishing the reason to know standard in favor of a more objective standard.

Senator HEINZ. May I interrrupt you again, with apologies, just to clarify the extent to which that policy has been in effect since 1977?

Mr. KEENEY. Yes, sir.

Senator HEINZ. And how long have you been with the Justice Department?

Mr. KEENEY. I've been there 35 years, Senator.

Senator HEINZ. Just starting out?

Mr. KEENEY. Just starting out.

Senator HEINZ. All right. You're one of those career professionals. Thank you very much, Mr. Keeney.

Mr. KEENEY. On third-party payments, we just have a technical amendment which is set forth in my statement which I think is merely for clarity purposes.

Now with respect to the exceptions, the proposed new subsection 104(c) of the act sets out several areas in which payments to foreign officials would be permissible under the act.

The first excepts from the act's coverage facilitating or expediting payments to expedite or secure the performance of a "routine governmental action," and is an attempt to alleviate the concerns of businessmen concerning payments made in connection with foreign business dealings.

Of course, here we must take care to ensure that routine governmental action is defined carefully so that what it is and what it is not is well understood. An effective way to accomplish this would be to include in S. 430 or in its legislative history definitions of what can and cannot be considered a routine governmental action.

We agree with Secretary Baldrige that you can't perfectly define these, but I think with some examples we could give a little more guidance than is given just by the terms.

EXCEPTION PERMITTED UNDER FOREIGN LAWS

The second exception would allow payments permitted under the laws or regulations of the foreign official's country. The Department's concern about this exception is that it may cause proof problems for the prosecution as well as for the defendants prosecuted under the act. I might note that as a practical matter there has never been an instance where conduct specifically permitted in a foreign country was the subject of a FCPA prosecution.

Mr. Chairman, to the extent the subcommittee deems an exception necessary, we in the Justice Department think it should be in the form of an affirmative defense.

Another exception involves payments which constitute a courtesy, a token of regard or esteem, or in return for hospitality. Provided that the legislative history sets forth in clear terms that this provision covers only payments or gifts of nominal value based on local custom, the Department has no objection to this provision.

Still another exception deals with expenditures associated with selling or purchasing of goods and services or with the demonstration or explanation of products, while a final exception covers "ordinary expenditures associated with the performance of a contract with a foreign government or agency thereof."

The Department would suggest that it be clarified that both of these exceptions are intended to be applied only in situations involving legitimate, bona fide and reasonable expenditures made to or for the foreign official in payment for or reimbursement of that foreign official's expenses only.

ECKHARDT AMENDMENT

Now, Senator, there's something that's not in your bill and we would like to propose that if you address the Eckhardt amendment that we, from an enforcement standpoint, would have a better piece of legislation.

The problem is, the prohibition against convicting an employee of a domestic concern unless the domestic concern itself is found to have violated the act. The purpose of this provision known in the present FCPA as the Eckhardt amendment was to prevent a company from labeling an employee as a renegade thereby making him a scapegoat for the company's criminal acts and forcing him to bear alone the full economic burden of defending the criminal charges. I said it wasn't in the bill. I'm sorry. It is in S. 430.

As we point out in some detail in our statement, the requirement of a corporate conviction creates enforcement difficulties where, one, the corporation has pleaded to a different violation, for example, in the one case, conspiracy to violate FCPA, and second where the corporation has pleaded nolo contendere.

Should the subcommittee wish to retain the language of Eckhardt, the Department would suggest that it clarify what is meant by "found to have violated." Alternatively, the subcommittee might wish to substitute some other language which more clearly sets out

the intent of Congress. We do not feel that Congress intended that guilty employees get off the hook merely because for one reason or another the company was not prosecutable, which is not the most likely case, or has for some reason or other been found guilty of a somewhat different offense.

If the subcommittee wishes to ensure that the goals of Eckhardt are met, we suggest adding language requiring a company to indemnify an employee's attorney's fees unless it can be shown that the employee was clearly operating as a renegade or without the company's knowledge. The Department, of course, is perfectly willing to work with the subcommittee to clarify the Eckhardt provision.

Now with respect to exclusivity, section 7 of S. 430 contains an exclusivity provision for bribery of foreign officials which prohibits the use of the mail or wire fraud statutes based on the theory that the foreign official or the domestic concern violated a duty to or defrauded the foreign government or the citizens of a foreign country, the so-called Kerner theory in the mail and wire fraud law.

We think this provision should make it clear that the restriction against the use of the mail and wire fraud statutes does not extend to cases where the Department determines it cannot effectively use the FCPA to prosecute subordinate officials or employees; for example, because of the above discussed problems created by the Eckhardt amendment.

Where the evidence reveals that despite explicit corporate policy to the contrary a renegade employee, agent, officer or domestic concern has been bribing foreign officials, the mail or wire fraud theory might be the only way to prosecute that individual. We also believe that any restriction on the Government's choice of charges should not apply to the plea bargaining phase.

Now, Mr. Chairman, as you discussed earlier with the Secretary, review procedures, section 8 of the bill would add a new section 105 to the act. It would require that the Department issue binding opinions with respect to the criminal provisions of the statute.

The Department does not believe that this provision is necessary since its general purpose is presently being met by the existing Foreign Corrupt Practices Act review procedure which we have had in place in the Department of Justice since March 1980.

The Department believes that the existing process works well and fairly and that the more elaborate review procedures set out in S. 430 would be unnecessary. Moreover, we think that the requirement that the Department provide such opinions within 30 days would not be feasible in most instances. That has been our experience, Senator. We can't respond in 30 days.

One of the primary reasons we can't respond is that there will be a submission and the submission will be inadequate, not because of the lack of capability on the part of the submitter but because on careful analysis we need additional information so that we can confine the opinion that's given to those particular facts.

Senator HEINZ. Let me interrupt you at this point. I have to briefly go to another appointment. I will be back within 15 minutes. Senator Hecht has graciously agreed to chair the hearing in my absence, but I will return. If I am unable to return prior to the wrapup of questioning, he will submit to you for an answer in writ-

ing or will ask himself some questions that I intend to ask or need to get answers to.

Senator Hecht, thank you very much. I present you with a token of your high office.

Senator HECHT. Thank you very much, Mr. Chairman. The second string will now come in.

Mr. KEENEY. Senator Hecht, I just have one more comment. It's with respect to the provision providing for guidelines.

Section 105(a) of S. 430 provides the Attorney General with the authority to issue guidelines concerning both the type of conduct which constitutes compliance with the criminal provisions of the act, as well as general precautionary procedures which businesses may voluntarily use to ensure compliance.

MORE USE OF ADVISORY OPINIONS

From a commercial as well as an enforcement point of view, the Department does not believe that issuing guidelines or precautionary procedures would be advisable. We frankly do not believe this procedure is necessary. We think that there should be more use made of the advisory opinions which are available to the business community.

The reasons we believe those guidelines are impractical are these. No matter how carefully crafted, guidelines would have the effect of unnecessarily restricting business transactions and possibly placing American business at a disadvantage with their foreign competitors.

The guidelines would be drafted by lawyers in the Department of Justice and those lawyers are going to bend over backwards to make certain that in the guidance that they give they do not provide any loopholes. We went through this routine in the last administration in late 1979 and early 1980 trying to come up with guidelines. We were under a great deal of pressure from our Attorney General at that time who wanted to give guidance to the business community. It was finally concluded that guidance was impractical, largely for the reasons which I'm giving, and that the best thing we could do insofar as giving guidance to the business community would be to respond to their specific requests in the form of the business review procedure.

I just might point out, Mr. Chairman, that in preparing any of those guidelines we do it in connection with the other agencies but it would be primarily our responsibility as the enforcement authority, and we would have to keep in mind that due process requires that these guidelines govern any position the Department later takes in a criminal case and we would be very reluctant to bind our hands with respect to future action.

While arguably helpful to businesses, such guidelines are not really necessary. Again, I say that the FCPA review procedure is available. We encourage the business community to make more use of it.

Mr. Chairman, that concludes my remarks. As I say, we support the bill, particularly with the modifications that we have suggested here today.

[The complete prepared statement follows:]

STATEMENT OF JOHN C. KEENEY
DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to present the views of the Department of Justice on S. 430, the "Business Accounting and Foreign Trade Simplification Act." This Act would amend the Foreign Corrupt Practices Act (FCPA). The Department supports S. 430 and its objective of removing unnecessary impediments to foreign trade, but will offer a few minor and technical suggestions to clarify and strengthen parts of it. I should stress here that none of our suggestions would detract in any significant way from the laudable aims of this legislation.

A. Conduct Prohibited

1. Liability of Agents

Subsection 5(b) of S. 430 completely rewrites section 104 of the FCPA, the criminal charging provision in the Act. 1/ The revised section 104 retains most of the language in the present section in that it prohibits the use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance

1/ Since section three of the bill changes the name of the Foreign Corrupt Practices Act to the "Business Practices and Records Act," succeeding sections of the bill refer to amendments in the "Business Practices and Records Act." Section 104 of the Act is set out at 15 U.S.C. 78dd-2, an unusual place for its codification since the Act was passed in 1977 (P.L. 95-213) and was not part of the Securities Exchange Act of 1934 which comprises the rest of chapter 2B in Title 15.

of a payment to a foreign official. However, unlike the present FCPA, section 104 omits agents from the Act's coverage.

The Department of Justice recommends that the Congress consider retaining agents specifically within the scope of S. 430. To eliminate them from coverage could decrease the Act's effectiveness. The majority of the FCPA cases which have been investigated involved payments made to "agents" or "consultants" who then forwarded all or a portion of the money they received to foreign officials. Although many of these "agents" or "consultants" were nationals of the foreign country whose officials were to be bribed, others were American citizens residing either in the foreign country or in the United States.

Retaining agents within the coverage of the Act specifically would accomplish three goals. First, it would give a clear warning to those who fall within this group that their actions have not been removed from scrutiny. Second, it would prevent courts from construing this section as not including agents. As will be discussed later, the present FCPA has been construed very narrowly and literally by the courts. Finally, it would maintain for the Department an effective investigative tool. We have found that some foreign governments are more willing to cooperate and to share evidence with the United States when we can show them evidence that their own citizens are violating the laws of the United States as well as of their own country. Without such mutual assistance, foreign bribery violations are often impossible to prove. Removing this impetus for cooperation would hamper

the already difficult investigative task of prosecuting such activity effectively.

2. Reason to Know

The present FCPA prohibits payments by United States business or individuals to a third party if the payor knows or has reason to know that all or part of those payments will be given by that third party to a foreign official. 2/ The revised section 104(b) set out in S. 430 would eliminate the "reason to know" language while retaining, in amended form, the remainder of the prohibition. The "reason to know" standard has never been used to prosecute anyone.

The Justice Department is sensitive to the unnecessary problems that the American business community has encountered in its attempts to interpret and apply the "reason to know" standard. We also know it is difficult to define exactly what constitutes "reason to know." For that reason, the policy of the Department has been to prosecute only those cases where the evidence of awareness -- whether direct or circumstantial -- was so clear as to constitute actual knowledge of the bribe scheme. This policy would not be changed by abolishing the "reason to know" standard in favor of a more objective standard and would improve the clarity of the Act.

2/ See Sec. 104(a)(3), (15 U.S.C. 78 dd - 2(a)(3)).

3. Third Party Payments

S. 430 would revise section 104(b) of the Act to prohibit a domestic concern or those acting on its behalf from using the mails or an instrumentality of interstate commerce "corruptly to direct or authorize, expressly or by course of conduct, a third party in furtherance of a payment, [or] gift . . . to a foreign official . . . ." As written, this section is confusing as to exactly what is prohibited, and would cause enforcement difficulties. We think the language should be clarified so that the offense would be ". .. corruptly to direct or authorize, expressly or by course of conduct, a third party to make a payment, [or] gift . . . to a foreign official."

B. Exceptions

The proposed new subsection 104(c) of the act sets out several areas in which payments to foreign officials would be permissible under the Act.

The first excepts from the Act's coverage facilitating or expediting payments to expedite or secure the performance of a "routine governmental action," and is an attempt to alleviate the concerns of businessmen concerning payments made in connection with foreign business dealings. Of course, we must take care to ensure that "routine governmental action" is defined carefully so that what is and is not permitted is well understood. An effective way to accomplish this would be to include in S. 430 or its legislative history definitions of what can and cannot be considered a "routine governmental action."

The second exception would allow payments permited under the laws or regulations of the foreign official's country. The Department's only concern about this exception is that it may cause proof problems for the prosecution and for defendants prosecuted under the Act. I might note that as a practical matter, there has never been an instance where conduct specifically permitted in a foreign country was the subject of a FCPA prosecution. To the extent the Subcommittee deems an exception necessary, we think it should be in the form of an affirmative defense.

Another exception involves payments which constitute a "courtesy, a token of regard or esteem, or in return for hospitality." Provided that the legislative history sets forth in clear terms that this provision covers only payments or gifts of nominal value, based on local custom, the Department has no objection to this provision.

Still another exception deals with expenditures "associated with selling or purchasing of goods and services or with the demonstration or explanation of products," while a final exception covers ordinary expenditures "associated with the performance of a contract with a foreign government or agency thereof." The Department would suggest that it be clarified that both of these exceptions are intended to be applied only in situations involving legitimate, bona fide, and reasonable expenditures made to or for the foreign official in payment for or reimbursement of that foreign official's expenses only.

C. Eckhardt Amendment

The Department also wishes to highlight a serious law enforcement problem in both the existing law and in new S. 430, with respect to the prohibition against convicting an employee (and, in the present FCPA, an agent) of an issuer or domestic concern unless the domestic concern itself is "found to have violated" the Act. The purpose of this provision, known in the present FCPA as the Eckhardt Amendment, was to prevent a company from labeling an employee as a renegade, thereby making him a scapegoat for the company's criminal acts, and forcing him to bear alone the full economic burden of defending the criminal charges as well as the potential criminal sanctions. This goal, unfortunately, has not been met. There is nothing to prevent a company from pleading guilty to a FCPA violation thereby forcing the employee or agent to defend by himself. Situations similar to this have occurred in the cases brought thus far.

While the Eckhardt provision falls short of fulfilling its purpose, it also makes it more difficult to prosecute certain classes of individuals regardless of the quantum of evidence as to their guilt or that of their employers. In the only reported opinion on this issue, an appellate court construed Eckhardt to mean that a company must be convicted of a FCPA violation rather than merely be "found to have violated" the act. 3/

3/ United States v. McLean, 738 F.2d 655 (5th Cir., 1984).

In that case, a company entered a pre-indictment guilty plea to conspiracy to violate the FCPA rather than to a substantive violation of the Act. The conspiracy plea was permitted because of the serious financial condition of the company and the real possibility that the imposition of a substantial fine would force it into bankruptcy. Two company employees were indicted for multiple FCPA violations as well as for conspiracy to violate the FCPA. The government offered to present proof beyond a reasonable doubt that the company had violated the FCPA and suggested that the Court instruct the jury to make the required Eckhardt finding prior to considering the guilt or innocence of the employees. The Court rejected these alternatives and dismissed the FCPA charges. In our view, this construction of the statute does not comport with the intention of Congress in enacting the Eckhardt language.

A similar problem exists where a company, over the objection of the United States, enters a plea of nolo contendere to FCPA violations. In that situation, a court could enter a judgment of conviction against the company for FCPA violations without necessarily making a finding as to guilt for purposes of the statute. Arguably, the United States might be prevented from prosecuting an employee or an agent of that company following such a conviction. Such an argument has recently been made by a fugitive defendant who, as agent for a domestic concern, acted as the conduit for transmitting in excess of 10 million dollars in bribes to two foreign officials on behalf of the company which pleaded no contest to 48 FCPA charges. Given the current state

of the law, the eventual resolution of this issue is not completely free from doubt. What is clear is that there is no justification for allowing conduct of this sort to go unpunished.

Should the Subcommittee wish to retain the language of Eckhardt, the Department would suggest that it clarify what is meant by "found to have violated." Alternatively, the Subcommittee might wish to substitute some other language which more clearly sets out the intent of Congress. If the Subcommittee wishes to insure that the goals of Eckhardt are met, we suggest adding language requiring a company to indemnify an employee's attorney's fees unless it can be shown that the employee was clearly operating as a renegade or without the company's knowledge. The Department is willing to work with the Subcommittee to clarify the Eckhardt provision.

D. Exclusivity

Section seven of S. 430 contains an exclusivity provision for bribery of foreign officials which prohibits the use of the mail or wire fraud statutes based on the theory that the foreign official or the domestic concern violated a duty to or defrauded the foreign government or the citizens of a foreign country. We think this provision should make it clear that the restriction against the use of the mail and wire fraud statutes does not extend to cases where the Department determines it cannot effectively use the FCPA to prosecute subordinate officials or employees -- for example, because of the above-discussed problems created by the Eckhardt amendment. Where the evidence reveals

that, despite explicit corporate policy to the contrary, a renegade employee/agent/officer of a domestic concern has been bribing foreign officials, the mail or wire fraud theory might be the only way to prosecute that individual. We also believe that any restriction on the government's choice of charges should not apply to plea bargaining.

E. Review Procedure

Section eight of S. 430 would add a new section 105 to the Act. Among other things, this section would require that the Justice Department issue binding opinions with respect to the criminal provisions of the statute. The Department does not believe that this provision is necessary since its general purpose is presently being met by the existing Foreign Corrupt Practices Act Review Procedure (FCPARP). FCPARP was voluntarily established by the Department of Justice in March of 1980. Its scope and requirements are set forth in §50.18 of the Code of Federal Regulations. Under FCPARP, Department prosecutors with experience in the investigation and prosecution of both pre-FCPA and FCPA bribery cases review proposed business conduct on a case-by-case basis. Based upon the advice of those prosecutors, the Department indicates whether the proposed conduct would be prosecuted in that particular case.

While the Department is prohibited from giving advisory opinions to attorneys in private practice, the FCPARP determinations of enforcement intent are of significant value. For example, while a literal interpretation of the FCPA would require

that a particular person be labeled a "foreign official," there have been several occasions where the Department has been able to indicate no enforcement interest in business transactions involving such persons under certain limited conditions. The Department believes that the existing process works well and fairly and that the more elaborate review procedures set out in S. 430 would be unnecessary. Moreover, we think that the requirement that the Department provide such opinions within 30 days would not be feasible in most instances.

F. Guidelines

Subsection 105(a) of S. 430 also provides the Attorney General with the authority to issue guidelines concerning both the type of conduct which constitutes compliance with the criminal provisions of the Act as well as general precautionary procedures which businesses may voluntarily use to ensure compliance. From a commercial as well as an enforcement point of view, the Department does not believe that issuing guidelines or precautionary procedures would be advisable. Accordingly, we do not feel that this provision is necessary.

The Department has determined that such guidelines are impractical for several reasons. No matter how carefully crafted, guidelines would have the effect of unnecessarily restricting business transactions and possibly placing American businesses at a disadvantage with their foreign competitors.

Moreover, the Department cannot place simple dollar limits on bribes or gratuities and then apply these limits uniformly. Reasonable business practices differ significantly from industry

to industry as well as from country to country. As a matter of policy, the Department cannot publicly ignore a small but otherwise corrupt transaction any more than it can place dollar limitations on the actions prosecutable under the mail or wire fraud statutes. If the Department promulgates guidelines, due process requires that these guidelines govern any position the Department later takes in any criminal case.

While arguably helpful to businesses, such guidelines are not really necessary. Under the FCPA Review procedure (FCPARP), a specific factual situation may be resolved without binding the Department in a case involving a somewhat different factual situation. The Department believes that FCPARP is the least restrictive and most useful process for resolving any instance of perceived ambiguity in interpretation of the FCPA and should be used in place of guidelines.

G. Conclusion

In conclusion, S. 430 offers thoughtful amendments to the FCPA, but we feel that some minor modifications along the lines we have discussed would improve its effectiveness for both the business community and the United States. We support your efforts in this regard.

I would be happy to answer questions at this time.

Senator HECHT. Thank you very much.

American businessmen operating abroad complain of the ambiguity and complexity of the present accounting provisions. Onerous, duplicative recordkeeping provisions and uncertain reporting requirements, bifurcated enforcements, criminal liability for noncompliance with the accounting rules, regardless of whether or not a firm is engaged in paying bribes, and uncertain liability for minority owners of subsidiaries.

In the SEC's perception, are these criticisms valid? How serious are the problems with the current accounting provisions? Who would like to tackle that or both of you?

OVERCOMPLIANCE OF BUSINESS

Mr. FLEISCHMAN. As to matters that arise under the provisions to which Mr. Keeney addressed his remarks, I think he will be answering most of the questions, and the Commission would defer to the Department in that area.

In the accounting area, Senator Hecht, so far as the provisions of the FCPA that amended the Securities Exchange Act are concerned, the Commission's concern has been since the very beginning that the spectre of exposure to, SEC enforcement for what may be deemed by American business to be technical and insignificant errors in corporate recordkeeping has had the effect, as it has been reported to us, of overcompliance with this statute, of forcing businesses to incur costs that are in fact not necessary to the effectuation of the purposes of the statute which have been explored at some length already here this morning.

Our support of S. 430 is based on the notion expressed by Senator Heinz, I think, in introducing this bill on the floor of the Senate, that we are anxious not to inhibit legal as well as illegal activities.

We are concerned that the lack of clarity in certain provisions of the act does have that effect.

Senator HECHT. Would you like to address that, Mr. Keeney?

Mr. KEENEY. The only thing I'd like to say, Senator Hecht, is that insofar as ambiguities in the act, when we discuss in our statement to so-called five exceptions, we have specific comments to make with respect to each one of those, examples and so forth, and tightening of the language using language such as bona fide, legitimate, and so forth, which we think would be helpful to the business community and also helpful from an enforcement standpoint.

Senator HECHT. Thank you.

Senator Proxmire, I'm pinch-hitting for Senator Heinz, so if you have some questions I will forego and let you ask yours and Senator Heinz can ask his when he returns.

You go right ahead, Senator Proxmire.

Senator PROXMIRE. All right. Fine. First, gentlemen, before I get into the questions, I do want to follow up on something in connection with the exchange I had with Secretary Baldrige.

I challenged Secretary Baldrige to show me a documented study that indicated that exports had been hurt by this law that's been on the books since 1977 and he referred primarily to a study by the International Chamber of Commerce.

COLLECTION OF SELF-SERVING ANECDOTES

The record shows that if you look at this International Chamber of Commerce study, it's nothing but a collection of self-serving anecdotes of businessmen hostile to the act. It's not a serious study in any way comparable to the study by Dr. Graham of the University of Southern California that shows that no business was lost because of the FCPA.

I would just say, whether it's the Secretary of Commerce or whether it's you gentlemen, if you have any kind of a detailed, documented study that shows that our exports have been hurt by the Foreign Corrupt Practices Act I would certainly like to see it.

Now, Mr. Keeney, as I read your testimony regarding exceptions to the bribery provisions, I went through those to some extent with the Secretary, I see that you agree with me and not Secretary Baldrige as to whether the provisions of S. 430 would create a loophole big enough to fly a Lockheed through.

If your amendments to the exceptions were not accepted, would you be against S. 430's enactment?

Mr. KEENEY. Well, let me put it this way, Senator Proxmire. If our amendments are accepted, we believe that we have a viable FCPA statute. I'd have to think about it if certain of the amendments weren't accepted.

Senator PROXMIRE. Well, I appreciate that but, of course, there is an outside chance that your amendments won't be accepted.

Mr. KEENEY. I understand that, Senator.

Senator PROXMIRE. As you know, this is not a new bill. An identical bill was put in in 1983 and 1981 too. So it's a bill that seems to stay intact, but I appreciate that.

Then your statement is that you would want to reconsider at least your support of S. 430 if your amendments are not included?

Mr. KEENEY. I don't know whether I want to go that far, Senator. We think it's a good bill. We think it could be a far better bill if our amendments are accepted.

Senator PROXMIRE. Well, Mr. Keeney, your Department has the obligation of enforcing this law. Let me give you a hypothetical situation. Let's imagine S. 430 with its five exceptions to the antibribery provisions of the FCPA are enacted. Now we have a businessman who's worked closely with a senior government official of a foreign country on a big contract for years in competition with other companies. It's the official's birthday and the businessman gives him a $25,000 Mercedes as a gift and a token of his esteem.

Is that illegal under the provisions of S. 430?

Mr. KEENEY. Senator, we'd have problems with that. We would have to think very seriously about that, the situation in the country, the customs and so forth. That's why we have suggested with respect to these that there be added in that these be legitimate, bona fide and in conformity with the customs in the country.

That seems a little high for—but that's one we would give a close look to.

Senator PROXMIRE. So it's possible that if it were bona fide and so forth that you would permit a $25,000 Mercedes. Supposing it weren't bona fide and it was just a $10,000 or $15,000 gift. Would that make a difference?

Mr. KEENEY. Well, you're assuming I assume, Senator, that there's a nexus, that somehow this official, the individual representative of our corporation has had some dealing with him, and has either gotten business or hopes to get business. We'd have to look at the total context. But when you're talking about a $25,000 Mercedes, it's something we'd have to look at.

Senator PROXMIRE. But my point is that won't enactment of S. 430 with these exceptions create more ambiguities than it resolves?

Mr. KEENEY. I don't think so. I think S. 430 helps and I think if you adopt our suggestions that it would be even better.

Senator PROXMIRE. Well, I cited a specific ambiguity here. Certainly the ambiguity may shift from the potential briber to the enforcement agency, but isn't there still an ambiguity here as to enforcement?

Mr. KEENEY. But, Senator, the type of situation you're referring to you really can't legislate down and have a perfect answer. You can't push a computer and come out with an enforcement action or a nonenforcement action based on the computer response. You've got to look at the totality of the circumstances. If you're dealing with a $25,000 Mercedes, we have to look at all the circumstances.

Senator PROXMIRE. But under the circumstances, wouldn't that type of transaction be clearly illegal under current law? It's simple, no ambiguity at all. It's wrong and it's illegal and you shouldn't do it.

Mr. KEENEY. I'm not prepared to say that it's clearly illegal. I'm prepared to say that it would be a matter of grave concern and we would look at the whole situation.

Senator PROXMIRE. Well, you would have an easier case under present law, wouldn't you?

Mr. KEENEY. I don't know; $25,000 is a lot of money, Senator.

Senator PROXMIRE. Now as you know, S. 430 would change the present standard governing responsibility for acts of agents from a "reason to know" standard to a "direct or authorize expressly or by cause of conduct."

Could you get a conviction under the latter standard—that is, "direct or authorize expressly or by cause of conduct?" Could you get a conviction under that standard of a corporation which hires an agent who's reputed to make illegal payments to win contracts?

Mr. KEENEY. It would depend, Senator, whether the total circumstances would suggest that the corporate officials who authorize the payments knew or they had a reckless disregard of whether or not bribery payments were going to be made.

Senator PROXMIRE. Well, this says "direct or authorize expressly or by course of conduct."

Mr. KEENEY. Yes.

Senator PROXMIRE. Again, it seems to me there's an ambiguity there.

IMPROVE CLARITY OF THE ACT

Then on page 3 of your testimony you say that a more objective standard than "reason to know" could improve the clarity of the act, but you make no suggestion as to what that standard should be.

Can you make a recommendation on that?

Mr. KEENEY. I'm suggesting that we could live without the "reason to know" provision because it hasn't been the basis of a prosecution previously. We have relied previously on the individual, the corporate official's conduct, and the general circumstances to determine whether or not what was paid to the agent was in fact a legitimate commission or whether there was included in there a bribe payment because of the excessiveness of the commission and other circumstances.

Senator PROXMIRE. Well, it seems to me that's more vague and more ambiguous than almost any standard we could specify.

Mr. KEENEY. Well, Senator, we've had the statute now for something a little over 8 years and we haven't used "reason to know" and it's a problem for the business community. Since we haven't used it, we see no reason to have it.

Senator PROXMIRE. You haven't used it but, as you know, there have been very few prosecutions. In fact, in the last 5 years there have been very few for bribery. There have also been some civil prosecutions because they haven't kept records properly, as I understand it. But it seems to me that there's still a deterrent factor here even if lots of cases are not being brought. One of the reasons there hasn't been a prosecution is that perhaps there hasn't been the same bribing activity as there was before this went on the books. And that would show up. Where we've had the convictions is not because this country took action but because another country took action, as in Japan and so forth.

Mr. KEENEY. Senator, we're the ones who took action in the Japanese situation. Thanks to the Securities and Exchange Commission, we were given evidence with respect to the conduct of our key people in Japan. We sat down with the Japanese. We executed

what was then a novel document, an executive agreement, to exchange information. It was the exchange of information which resulted in action.

Senator PROXMIRE. Well, I appreciate that. What I'm talking about is action commensurate with the crime. We took some small wrist-slapping action, against Lockheed. The Japanese took some real action against the Prime Minister.

Mr. KEENEY. But this was before your statute, Senator.

Senator PROXMIRE. Are you aware of any unjust criminal prosecutions under FCPA?

Mr. KEENEY. No, sir; obviously not. If there were any unjust prosecutions I'd do something about it.

Senator PROXMIRE. How many criminal cases have been brought?

Mr. KEENEY. Senator, 25 have been prosecuted.

Senator PROXMIRE. How many have you won?

Mr. KEENEY. I think we have lost parts of some cases. For instance, the one that I referred with respect to the Eckhardt amendment where we lost the employees because of the court's construction of Eckhardt as requiring a conviction of the company for FCPA itself as distinguished from a conspiracy as a prerequisite to the conviction of the employee. We've won most of them, Senator.

BRIBERY CASE

Senator PROXMIRE. Mr. Fleischman, earlier this year it was reported that the Securities and Exchange Commission voted 2 to 1 against suing Ashland Oil and its former chairman, Owen Atkins, for allegedly bribing Yemeni officials in 1980 to obtain crude oil. In doing so, the Commission rejected the Enforcement Division's recommendation that Ashland be charged with violating the antibribery provisions of the Foreign Corrupt Practices Act.

Less than 3 weeks later, in a rare reversal, the Commission voted to charge Ashland with violating the Foreign Corrupt Practices Act. I am told that you originally voted against bringing the case. Is that correct?

Mr. FLEISCHMAN. Yes, sir; I did.

Senator PROXMIRE. Then when the Commission voted to reverse itself, I'm told you again voted against the Division of Enforcement's recommendation to bring the case. Is that correct?

Mr. FLEISCHMAN. Yes, sir; I did.

Senator PROXMIRE. What led the Commission to reject the Enforcement Division's original recommendation to bring the case and why the reversal so quickly thereafter?

Mr. FLEISCHMAN. The Enforcement Division had advised the company, I believe, Senator, at the time that it passed on the very first recommendation—the very first report of action by the Commission—that the Division felt the matter should go back to the table. The matter did come back to the table. The Division most effectively presented its case the second time.

As you know, Senator, it is difficult and not in accord with Commission policies to have even Commissioners discuss matters that are still under investigation or have not emerged into a full public proceeding. I have no hesitation in speaking about my own conduct

and my own vote, but I do feel reluctant to go beyond that in discussing anything affecting Ashland.

Senator PROXMIRE. Let me proceed by asking you this. Is it true that during the Reagan administration until this case the SEC had filed only one lawsuit invoking the antibribery provisions of the FCPA?

Mr. FLEISCHMAN. I believe that to date the Commission has brought only two cases; yes, sir.

Senator PROXMIRE. How do you respond to the criticism that this administration and the SEC under John Shad has been soft on bribery?

Mr. FLEISCHMAN. I respond by pointing out respectfully, Senator, that the Enforcement Division under Chairman Shad's leadership treats allegations of bribery here or abroad in the same way that the Enforcement Division treats any other allegation of a violation of any provision of the law that the Commission is directed to enforce.

Senator PROXMIRE. Given your votes on the *Ashland* case, what assurances can you give us that you personally believe that all aspects of the Foreign Corrupt Practices Act should be vigorously enforced by the Commission?

Mr. FLEISCHMAN. It is difficult to give you assurances, Senator, without discussing at some great length the particular case, but I can assure you of this, Senator: whatever the vote, even when it is divided at the Commission, once voted, the Commission is unanimous in following up on the majority's decision.

Senator PROXMIRE. Later today, Mr. Fleischman, Arthur Mathews will testify that "the proposed amendment in S. 430 significantly narrowing the scope of section 13(b)(2) will needlessly curtail the SEC's effectiveness in so-called cooked-books cases."

I ask you, do you want to curtail the SEC's effectiveness in this area and what is your response to his statement?

Mr. FLEISCHMAN. I do not, Senator, want to curtail the SEC's effectiveness in the enforcement of the Securities Exchange Act. I have seen since it was available outside this hearing room, Mr. Mathews' testimony. I know Mr. Mathews personally and know him to be a very fine lawyer in his field.

Respectfully, I disagree with his conclusion on that matter, and in certain other aspects of his testimony that he has not yet presented to the subcommittees.

The Commission does not see the amendments proposed to section 13(b)(2) as in any way curtailing its effectiveness in connection with what Mr. Mathews calls cooked-books cases.

Senator PROXMIRE. Well, I appreciate your remarks and with respect to Mr. Mathews I have the same high respect for him, as I have for you.

One final question. Does the Enforcement Division of the SEC support the testimony you have given here today?

Mr. FLEISCHMAN. The Division has reviewed, commented, and made suggestions with respect to the testimony I have given. Not every one of those comments has been incorporated into my testimony, but I think it fair to say to you, yes, the Division and the other Commissioners support the testimony I've given here today.

Nobody has spoken, save me, in response to your questions on Ashland, Senator.

INSIDER TRADING

Senator PROXMIRE. I'm reminded that I do have, if the chairman would permit, just one other question that I meant to ask.

I'd like to follow up on two questions I asked you for the record at your confirmation hearing on November 14 of last year. They both involve serious allegations of securities laws violations.

First, with respect to the Phillips Petroleum takeover battle, what is the SEC doing regarding the charges of insider trading among arbitragers and the filing of false and fraudulent materials in that case?

Mr. FLEISCHMAN. To the extent that the Commission and its Enforcement Division decide to pursue investigations that might lead to enforcement proceedings, Senator, it is the policy of the Commission to bar members of the staff and Commissioners from responding to questions on those subjects.

Of course, the staff of the Commission is available to the staff of these subcommittees to discuss matters under our normal arrangements with the subcommittees.

Senator PROXMIRE. Then there's the question with respect to columnist William Safire, who's highly respected, and I want to know what you've done and what action has been taken since I asked you to followup on the allegation raised in the Safire article dated July 8, 1985, involving Prudential-Bache Securities entitled "Soft on Brokers."

Mr. FLEISCHMAN. Yes, I recollect that article well and your question. I did pursue it. Unfortunately, I have to give you the same response that I gave to your immediately prior question, Senator.

Senator PROXMIRE. Thank you.

Thank you, Mr. Chairman.

Senator HEINZ. Commissioner Fleischman, I have a couple of questions for you on the accounting provisions of S. 430. As you know, it would eliminate the duplication of effort by incorporating the recordkeeping requirements into the principle of internal control and would explicitly make cost benefit analysis the basis for determining the reasonableness of adopted accounting systems.

Now clearly, this would streamline the accounting burden, but I want to know, do you believe it would reduce in any way the vigilance of U.S. firms in avoiding bribery or, for that matter, reduce in any way the SEC's ability to enforce the law?

Mr. FLEISCHMAN. No, sir; I do not.

Senator HEINZ. Now with regard to enforcement, S. 430 consolidates enforcement of the antibribery provisions with the Justice Department while retaining for you, the SEC, civil enforcement of accounting provisions. It would also delete criminal responsibility for failure to comply with the accounting provisions and provide a good faith standard to evaluate the conduct of minority owners in regard to the actions of subsidiaries.

Do you believe that this focus of SEC enforcement efforts on the accounting provisions through the civil penalties is appropriate,

and will it limit your ability to enforce the laws in any way effectively?

Mr. FLEISCHMAN. I do not believe it will, Senator.

Senator HEINZ. Mr. Keeney, in 1981 and 1983 the administration endorsed the provisions contained in S. 430 and Secretary Baldrige has done that on a third occasion today. You have testified to some changes of varying degrees.

Does the Justice Department support the enactment of S. 430 whether or not we amend it as you've suggested?

Mr. KEENEY. Well, we would follow the administration and support it, but we strongly urge that you give serious consideration to our proposals. If you accept our proposals, we think the enforceability of the act and the notice that's given to the business community will be substantially enhanced. Particularly in the Eckhardt situation, I think that's important because we've demonstrated in two cases there that the Eckhardt amendment, despite its intended purpose, is actually an enforcement impediment as presently drafted, and I think all we're dealing with here is a drafting amendment, Senator.

Senator HEINZ. Under the FCPA, both you and the SEC are responsible for enforcement of the antibribery provisions. As I mentioned just a moment ago, they are consolidated here with you and we seek to clarify the standard of conduct. You discussed that in your testimony for U.S. exporters.

Will those changes enhance the Justice Department's ability to enforce civil and criminal remedies for violation of the antibribery provisions?

Mr. KEENEY. Well, as I say, if you accept the proposals that we made, there will be an enhancement. We'll be able to effectively enforce the statute. We will be able to do it more effectively if you do something about the Eckhardt amendment.

COOPERATIVE SPIRIT

Insofar as the SEC's responsibility, we have always worked well with the SEC and we've had no problems working with them. Giving them total responsibility for the recordkeeping or accounting provisions and giving us total responsibility for the antibribery should create no problems from my perspective.

As a matter of fact, I know we can rely on the practice of the SEC. If they're looking at it from the accounting standpoint they find indications of bribery, I'm very confident they will readily be referred to us.

Senator HEINZ. So you're saying that if we address the problem that you brought up with the Eckhardt amendment, you think that that could actually improve the effectiveness of the act?

Mr. KEENEY. The Eckhardt amendment would improve the enforcement; yes, sir.

Senator HEINZ. In another area, as you know, we propose in S. 430 to remove criminal responsibility for failure to meet the statute's accounting standards while focusing criminal penalties on the crime of bribery itself.

Do you believe that this change—that is, removing criminal penalties for failing to meet the accounting standards—will lessen the statute's deterrent effect?

Mr. KEENEY. In the bribery area?

Senator HEINZ. Yes.

Mr. KEENEY. I'm inclined to think not, but I would defer to my colleague, Mr. Fleischman, on that.

Senator HEINZ. Mr. Fleischman, do you see any lessening of the deterrent effect given the changes that S. 430 makes in the accounting area?

Mr. FLEISCHMAN. I don't believe so, Senator Heinz. I had understood that to have been a question which you asked me earlier.

Senator HEINZ. Very well. I may have some additional questions on your testimony, Mr. Keeney. I frankly did not see it last night and didn't have a chance to go over it. You made a lot of interesting suggestions and I will want to review it and submit some questions to you for the record.

[Response to written questions of Senator Heinz may be found on p. 149.]

Mr. KEENEY. We were a little late getting it in, Senator. We apologize for that.

Senator HEINZ. Very well.

Mr. FLEISCHMAN. Mr. Chairman, in response to a question from Senator Proxmire, as I played back my answer to myself, with your permission, I should like to expand on one point.

The Senator asked about whether the Enforcement Division of the SEC subscribes to the testimony that I've given here today.

When members of the staff of the SEC go out lecturing, they are under our rules required to give a disclaimer that they are speaking for the Commission. I suppose it is only appropriate for any Commissioner to give a similar disclaimer that he is speaking for any particular individual within the staff of the Division of Enforcement. I do not know that any individual within the staff of the Division of Enforcement would subscribe to all my testimony here today.

Senator HEINZ. I have one last question for Mr. Keeney. I may have missed this in your testimony because I left right toward the end of your testimony.

REVIEW PROCEDURES

Under the bill, the Attorney General would establish procedures to review business practices and records to respond to specific inquiries concerning foreign payments. Advisory opinions that were issued would be final and binding on all parties unless new evidence was discovered which was at variance with the facts on which the opinion was based.

Does the administration and/or does the Justice Department support that provision?

Mr. KEENEY. Well, we don't support it, Senator, and the reason we don't is because we think it's unnecessary. We have in place the review procedure and we've had it in place since 1980 which accomplishes what this provision is intended to accomplish, and it doesn't put us in stone, as it were, with respect to the time in which we respond. I responded to one of your colleague's questions earlier——

Senator HEINZ. On the 30 days?

Mr. KEENEY [continuing]. The 30 days. It's really unrealistic because rarely do we get a request where we get all the information in the initial contact and there are repeated contacts. And, frankly, we don't think there's anything in the bill that you're trying to accomplish that we're not now prepared to accomplish. If we give an opinion and the particular company acts within the parameters of that opinion, we will not prosecute. We feel bound, as a matter of fact as a matter of estoppel we would be bound. So we don't think the legislation is necessary in this particular aspect of it.

Senator HEINZ. Is your main problem the 30 days?

Mr. KEENEY. Well, we're concerned—we have what we think is an effective operation. Putting it into legislation, we don't know how it will ultimately end up. What we would encourage is for the business community to take more advantage of the availability of this process.

Senator HEINZ. But you don't really have any problem with the advisory opinions being final and binding with the proviso that I mentioned?

Mr. KEENEY. Not if they're confined to the four corners of the document that's submitted setting forth t! facts because we feel bound in that regard right now.

Senator HEINZ. I understand that and, as I explicitly stated, they would be binding only so long as there was no new evidence that was discovered which was at variance with the facts on which the opinion was based.

Mr. KEENEY. We set that forth in the dialog with the submitter, that any deviation from the fact as submitted will render the opinion null and void.

Senator HEINZ. So what's in the bill and what your policy is are identical in that regard?

Mr. KEENEY. They are pretty close.

Senator HEINZ. Very well.

Senator PROXMIRE. Mr. Chairman, could I ask Mr. Keeney one question?

Senator HEINZ. By all means.

Senator PROXMIRE. Mr. Keeney, I'd like to ask you if you would drop the "reason to know" what alternative would you provide instead?

Mr. KEENEY. Well, you could either go—the present language would probably be acceptable.

Senator PROXMIRE. The present language in the act?

Mr. KEENEY. The present language that we've suggested would probably cover most of the situations that might come up in this situation and we would look then as I indicated previously at the——

Senator PROXMIRE. I want to make sure I understand what you're talking about. What language is that, sir?

Senator HEINZ. Are you referring to the language in S. 430 which authorizes either explicitly or by course of conduct?

Mr. KEENEY. Course of conduct is what I'm particularly referring to. The course of conduct could be the historical relationship in that particular country with that particular individual. The amount of money that was given you could infer a criminal intent

to violate the statute from that and there's also available in the law now, in the common law, the concept known as reckless disregard. In other words, there's a pattern of this individual having paid bribes in the past, the agent, and he asks for an exorbitant commission and you give it to him without regard to what he's going to do with it. I think we can live with it, Senator Proxmire.

Senator PROXMIRE. Thank you, sir.

Senator HEINZ. Thank you very much, gentlemen.

Senator PROXMIRE. If you could give us better language, we would appreciate it. Think about it.

Senator HEINZ. Our next panel consists of Mr. Cal Cohen, Allen Green, and Arthur Mathews. Gentlemen, please come forward.

Mr. Cohen, by virtue of either luck or alphabetical order, you are the first to testify according to our witness list. Please proceed. You're no stranger to this committee. We welcome you back.

STATEMENT OF CALMAN J. COHEN, VICE PRESIDENT, EMERGENCY COMMITTEE FOR AMERICAN TRADE

Mr. COHEN. Thank you, Mr. Chairman. I am Calman Cohen, vice president of the Emergency Committee for American Trade [ECAT], an organization of the leaders of 61 large U.S. firms with extensive overseas business interests. I am here today to present their views concerning the desirability of amending the Foreign Corrupt Practices Act.

ECAT member companies had 1985 worldwide sales of about $700 billion and employed over 5 million people. The companies are major U.S. exporters. They contribute significantly to the U.S. balance of payments both through their exports and through the profits earned by their foreign affiliates and joint ventures.

ECAT SEEKS GREATER CLARITY OF FCPA

Mr. Chairman, we in American business have no quarrel with the act's basic purpose of providing penalties for illicit payments to foreign officials. Such payments are outside the bounds of acceptable business conduct.

For the members of ECAT the problem is with the ambiguities of the act, and, with all due respect to the ranking minority member, we do differentiate between the ambiguities of the act and payments for illicit purposes which are prohibited by the act.

We believe that the ambiguity and complexity of this legislation frustrate the very objective that Congress sought to achieve in 1977, namely, preserving the competitiveness of U.S. exporters provided that they shun improper payments to obtain business.

At an earlier appearance, Mr. Chairman, before this committee, we were asked to survey ECAT members to see if they could estimate compliance costs and sales losses resulting from refusals to seek business because of uncertainty as to whether the FCPA would be violated—uncertainties, I might point out, that S. 430 is intended to correct.

Many of our respondents in ECAT simply stated that estimates were not possible. Another group responded that compliance costs had either not been increased enough to measure or had not been

raised at all since their corporate accounting systems already met the requirements of the FCPA.

A large group of respondents indicates that accounting and legal compliance costs had been increased significantly, in many cases by millions of dollars annually.

A large group of companies responded that because they were uncertain whether certain business practices were prohibited by the act they refused to seek business contracts. While in few cases could it be demonstrated that the FCPA ambiguities were the sole cause for losses of business, a number of companies estimated that ambiguities of the FCPA were a factor in losses of business totaling over $2 billion.

We believe that these results demonstrate that U.S. exports would clearly be facilitated through FCPA amendments clarifying current ambiguities in the statute.

With regard to the study of Professor Graham and, again with great respect for the ranking minority member, I have looked at the study of Mr. Graham and have not made reference to it because I do not believe it supports the arguments that we in the business community are making. Mr. Graham is studying whether, as I understand it, the paying of bribes would result in increased exports for American business. We in business, we in ECAT, are saying what we want is a clarification of various provisions of the act to remove ambiguity. We do not make the argument that we are seeking to pay bribes in order to increase exports.

Let me just try to highlight six areas where we feel that the bill, S. 430, appropriately handles some of the problems that have been identified.

"REASON TO KNOW" PROBLEM

As in 1981, when we testified before the committee, we approach each of the key proposed changes from the perspective of what Congress sought to achieve in the initial statute. Our statement seeks to show that the key provisions of the bill would respond appropriately to those problems by clarifying and simplifying the law.

First, as previous witnesses, including those of the administration, have pointed out, no provision of the act has caused American business greater problems than that prohibiting payments to "any person while knowing or having reason to know" that a foreign official will ultimately receive the payment. This provision causes serious problems because it imposes criminal liability on U.S. companies for the actions of others and does so without establishing clear standards for U.S. companies to follow.

Domestic bribery law does not provide guidance. There is no analogy to the "reason to know" provision in domestic bribery law. Responsibility attaches under the "reason to know" provision regardless of whether U.S. business intends to have the third person make improper payment.

The problem, as previous witnesses have pointed out, is particularly acute because the third parties in question are usually foreign nationals. Often, U.S. business is required to employ such a national. United States businessmen have difficulty retaining the services of the most competent representatives if as a condition for the en-

gagement the local national has to agree not only to a far-ranging initial investigation of his activities but also to repeated requests for proof that U.S. standards for conducting business are being met.

In short, ECAT members find the absence of clarity to be a serious impediment to enhancing export markets. We believe there is a need for a clear line of liability, a clear, bright line. We would support imposing liability in a situation where a U.S. business has circumvented the bribery prohibition of the FCPA by authorizing or directing a third person to make an improper payment. The approach adopted in S. 430 would also meet with support.

SO-CALLED GREASE PAYMENTS

A second area that I would like to reference has to do with facilitating or expediting payments. From the very first hearing on the proposed legislative response to published reports of improper payments, Congress recognized the distinction between bribes and so-called grease payments. The FCPA sought to deal indirectly with the issue by defining the type of official involved. In practice, this approach has failed to achieve Congress' intent. Even in our own Federal Government it is difficult to know when an official has essentially ministerial or clerical duties.

S. 430 would focus the exception on the purpose of the payments rather than on the recipient. The key inquiry would be for what is the payment being made and is such a payment customary in the foreign country in order to facilitate or expedite performance.

Third, the FCPA sought to prevent U.S. business from engaging in practices that were unquestionably illegal in the country where made. After enactment of the act, it became apparent to our members that they might also be prohibited from taking actions which are entirely legal in foreign countries. We do not believe Congress intended to prohibit American business from engaging in conduct that was legal under the applicable foreign statutes.

S. 430 proposes to make clear that U.S. business will not be prohibited by the act from engaging in conduct that is lawful under the applicable local laws and regulations. The provision will permit U.S. companies, for example, to retain the services of individuals who serve as part-time public servants and are authorized by local law to perform outside activities provided that they avoid conflicts of interest.

Fourth, ECAT members support enactment into law of what is reported to be the policy of the Justice Department to rely exclusively on the FCPA to prosecute U.S. companies for foreign government bribery, as was presented with some qualification by the representative of the Department of Justice.

Whatever the legal merits of applying more than one statute to the same conduct, there is now a sound basis in policy for providing expressly that the FCPA alone governs when a foreign governmental bribe is subject to criminal prosecution.

On books and records, another major area of ambiguity and a fifth point, there is a need for defining the reach of the provisions of the act. S. 430 removes a great deal of ambiguity regarding the reach of the accounting provisions by providing to them a reasona-

ble test. Most importantly, it would tie the recordkeeping requirement to the purpose of achieving the statutorialy specified objectives of internal accounting controls.

Sixth and last, the absence of an express scienter requirement in the accounting section of the FCPA exposes American business to potential criminal liability for unintentional errors in the company's books. S. 430 would make clear that Congress intended the accounting section of the FCPA to be framed in terms of the abuses that were revealed in 1977.

S. 430 proposes a number of other significant improvements in the act which ECAT supports, including a good faith obligation of an issuer for the recordkeeping and internal accounting controls of a domestic firm in which the issuer holds 50 percent or less of the voting power as well as strengthening the responsiveness and confidentiality of the business review procedure.

In conclusion, we appreciate this opportunity to testify on a most important legislative issue. We believe that until S. 430, Mr. Chairman, is enacted into law American business will continue incurring the needless costs that result from the application of provisions of the FCPA which Senator Chafee was the first to address in reform legislation and which you, Mr. Chairman, and many of your colleagues now seek to improve.

Thank you.

[The complete prepared statement follows:]

STATEMENT OF CALMAN J. COHEN, VICE PRESIDENT
EMERGENCY COMMITTEE FOR AMERICAN TRADE
BEFORE THE SUBCOMMITTEES ON INTERNATIONAL FINANCE
AND MONETARY POLICY AND SECURITIES OF THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
ON THE BUSINESS ACCOUNTING AND FOREIGN TRADE SIMPLIFICATION ACT, S. 430

June 10, 1986

Mr. Chairman, I am Calman J. Cohen, Vice President of the Emergency Committee for American Trade (ECAT), which is an organization of the leaders of 61 large U.S. firms with extensive overseas business interests. I am here today to present their views concerning the desirability of amending the Foreign Corrupt Practices Act (FCPA).

ECAT member companies had 1985 worldwide sales of about $700 billion and employed over five million people. The companies are major U.S. exporters. They contribute significantly to the U.S. balance of payments both through their exports and through the profits earned by their foreign affiliates and joint ventures.

Mr. Chairman, American businessmen have no quarrel with the FCPA's basic purpose of providing penalties for illicit payments to foreign officials. Such payments are outside the boundaries of acceptable business conduct.

The basic problem for the member firms of ECAT is the ambiguities of the FCPA. The ambiguity and complexity of this legislation frustrate the very objective that Congress sought to achieve -- namely, preserving the competitiveness of U.S. exporters provided that they eschewed improper payments to obtain business.

At an appearance before an earlier Banking Committee hearing, we were asked to survey ECAT members to see if they could estimate both compliance costs and sales losses resulting from refusals to seek business because of uncertainty as to whether the FCPA would be violated -- uncertainties that S. 430 is intended to correct. In light of the sensitivity of the issue, we were surprised to receive a goodly number of responses to our two questions.

Many respondents simply stated that estimates were not possible. Another group responded that compliance costs had either not been increased enough to measure or had not been raised at all since their corporate accounting systems already met the requirements of the FCPA. A number of respondents noted that their corporate standards of conduct had pre-dated the FCPA, and that, therefore, there could be no sales losses attributable to the FCPA.

But a rather large group of respondents indicated that accounting and legal compliance costs had been increased significantly, in many cases by millions of dollars annually.

Others noted a large start-up cost associated with complying with the FCPA's accounting requirements but also noted modest annual additional costs of administering the new controls after they were instituted.

A large group of companies responded that because they were uncertain whether certain business practices were prohibited by the FCPA, they refused

to seek business contracts. While in few cases could it be demonstrated that the FCPA ambiguities were the sole cause for losses of business, a number of companies estimated that ambiguities of the FCPA were a factor in losses of business totaling over $2 billion.

In conducting our survey, we guaranteed that responses would be treated in absolute confidence.

We believe that the results clearly demonstrate that U.S. exports would clearly be facilitated through FCPA amendments clarifying current ambiguities in the statute.

The balance of this statement analyzes the amendments to the FCPA in S. 430. As in 1981 when ECAT testified before the Committee, we approach each of the key proposed changes from the perspective of what Congress sought to achieve in the initial statute adopted in 1977. We identify the problems for ECAT members arising from that statute. Our statement seeks to show that the key provisions of S. 430 would respond appropriately to those problems by clarifying and simplifying the law. At the same time, our purpose is to demonstrate that with the proposed changes the FCPA would continue to fulfill the policies that Congress wished to carry out in 1977.

1. Imposing Liability for Third Party Payments.

No provision of the FCPA has caused American business greater problems than that prohibiting payments to "any person, while knowing or having

reason to know" that a foreign official will utimately receive the payment. Congress included the provision in the FCPA in response to the finding that some U.S. companies had deliberately used foreign intermediaries -- agents, sales representatives and the like -- as mere conduits for making improper payments to foreign government officials. Yet, the "know or reason to know" provision has gone far beyond the issue which Congress sought to address.

This provision causes serious problems because it imposes criminal liability on U.S. companies for the actions of others and does so without establishing clear standards for the U.S. companies to follow. Domestic bribery law does not provide guidance. There is no analogous to the "reason to know" provision in domestic bribery law. Liability for payments to foreign officials could result under circumstances in which no liability would result if payments were made to U.S. officials.

Responsibility attaches under the "reason to know" provision regardless of whether the U.S. business intends to have the third person make an improper payment. American business is asked to determine with certainty that third parties will not engage in certain conduct and to risk criminal prosecution if their judgment turns out to be incorrect.

The problem is particularly acute because the third parties in question are usually foreign nationals. Often a U.S. business is required by local law or regulations to engage their services. U.S. businessmen have difficulty retaining the services of the most competent local representatives if, as a condition for the engagement, the local national is

asked to agree not only to a far-ranging initial investigation of his business activities but also to repeated requests for proof that U.S. standards for conducting business are being met. Indeed, the most effective local representatives in many countries are honorable and honest men who do not engage in improper practices. But they resent American attempts to tell them how to behave. They further resent demands for concrete evidence that they are meeting American expectations. This is especially so when the governments of our principal foreign trade competitors impose no similar obligations on their industries in dealing with overseas representatives.

In many cases, U.S. exporters sell manufactured products to a foreign dealer who is responsible for their resale. In that situation the U.S. exporter often has minimal involvement in the marketing of the products and no equity or other financial interest in the dealer's operations. Nevertheless, the FCPA could be interpreted to create criminal liability for the U.S. exporter if the foreign dealer makes an improper payment with his profit from sales of equipment that he purchased outright from the U.S. supplier.

In short, ECAT members find the absence of clarity in the "know or reason to know" provision to be a serious impediment to enhancing export markets. There is a need to establish a clearer line of liability for third party conduct. ECAT members believe that the appropriate standard would be to impose liability if a U.S. business has circumvented the bribery prohibition of the FCPA by authorizing or directing a third person to make an improper payment. The approach adopted in S. 430 would also meet with support. Specifically, S. 430 would impose liability if a U.S. business has circumvented the bribery prohibition of the FCPA by authorizing or directing, expressly or by a course of conduct, a third person to make an improper payment.

Either alternative to the "know or reason to know" provision would return to the issue that Congress sought to address in 1977 -- the deliberate use of foreign intermediaries to evade a prohibition on foreign bribery.[1] At the same time, the change would remove the ambiguity and unnecessary burden for American business resulting from the standard included in the current statute.

2. Facilitating or Expediting Payments.

From the very first hearing on the proposed legislative response to published reports of improper payments, Congress rscognized the distinction between bribes and so-called "grease" payments. For example, the then Chairman of the Securities and Exchange Commission, Roderick Hills, testified in 1976 that "[m]any companies have indicated that 'facilitating' payments to low-level officials are customary and legal in certain parts of the world and that continuation of such payments is necessary in order to transact business."[2] In the Senate report on the 94th Congress bill (S. 3664), the Committee on Banking, Housing and Urban Affairs stated that it "deliberately cast the language narrowly" to differentiate between bribes and "low-level facilitating payments sometimes called 'grease payments.'"[3]

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[1] See, e.g., "Unlawful Corporate Payments Act of 1977," Hearings on H.R. 3815 and H.R. 1602 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess. 30 (1977) (testimony of Dr. Gordon Adams on the use of sales agents to carry out improper foreign payments).

[2] Hearings Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d. Sess. 20 (Sept. 21, 1976).

[3] S. Rep. No. 94-1031, 94th Cong., 2d. Sess. 6 (July 2, 1976).

When the FCPA was enacted in 1977, it unfortunately addressed only indirectly the facilitating payments problem. This has created confusion, even though there was no doubt of Congress' intent in 1977 to exempt such payments. Indeed, the reports of both the Senate and House stated explicitly that the "statute does not... cover so-called grease payments."[4] On the floor of both Houses, similar statements were made by key legislators involved in enactment of the FCPA.[5]

The FCPA sought to deal indirectly with the issue of facilitating payments by defining the type of official involved. Specifically, "foreign official" is defined not to include "any employee of a foreign government or any department, agency or instrumentality thereof whose duties are essentially ministerial or clerical." (Sec. 103(a) and 104(d)(2), emphasis added.) Under the FCPA, payments to a foreign government employee who falls within this exclusion are outside the statutory proscriptions.

In practice, this approach has failed to achieve Congress' intent. Even in our own federal government, it is difficult to know when an official has "essentially ministerial or clerical" duties. The problem is acute in foreign countries where the duties of government employees are less clearly articulated and usually not readily available in published form.

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[4]S. Rep. No. 95-114, 95th Cong., 1st Sess. 10 (1977); H. Rep. No. 95-640, 95th Cong., 1st Sess. 8 (1977) (with exclusionary langauage similar to that of the Senate report).

[5]Statements of Senator Tower and Congressmen Devine and Eckhardt at 123 Cong. Rec. 38801-02, 38778 and 36304 (1977), respectively.

S. 430 would focus the exception on the purpose of the payments rather than on the recipient. A permissible action would be "any facilitating or expediting payment to a foreign official the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official." Thus, the key inquiry would be for what is the payment being made and is such a payment customary in the foreign country in order to facilitate or expedite performance. This is an entirely appropriate approach to the issue since that is how Congress addressed the question throughout the hearings and debates leading to the enactment of the FCPA. By returning to its original concept, Congress would remove the uncertainty and concern of the American business community that have resulted from the indirect and less satisfactory formula adopted in 1977.

3. Payments Which Are Lawful Where Made.

The FCPA sought to prevent U.S. business from engaging in practices that were unquestionably illegal in the country where made. In 1976, the Law Library of Congress prepared several studies which demonstrated that virtually every developed and developing country had legislation prohibiting bribery of its public officials to secure business.[6] After enactment of the

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[6]Law Library, Library of Congress, "A Compilation of Bribery and Extortion Laws in OPIC Countries" (No. 76-1078 LL) and "Bribery Laws in Denmark, England, France and the Federal Republic of Germany" (No. 76-1249 LL).

FCPA, it became apparent to ECAT members that they might also be prohibited from taking actions which are entirely legal in foreign countries. This result would not be consistent with the purposes of the FCPA and is not supported by the hearings that led to its enactment. We do not believe that the Congress intended to prohibit American business from engaging in conduct that was legal under the applicable foreign statutes and in which, by definition, foreign competitors of U.S. exporters could freely and lawfully participate.

The problem arises from confusion under the FCPA over whether the actions of U.S. business should be judged under U.S. legal standards or those of the foreign country. S. 430 proposes to make clear that U.S. business will not be prohibited by the FCPA from engaging in conduct that is lawful under the applicable local laws and regulations. This amendment would, for example, allow corporate political contributions in those countries where they are entirely legal. Similarly, the provision would permit U.S. companies to retain the services of individuals who serve as part-time public servants and are authorized by local law to perform outside activities provided that they avoid conflicts of interest. U.S. companies would, of course, need to satisfy themselves as to the content of foreign law in order to ascertain whether they would be permitted to engage in proposed conduct in specific cases.

4. Establishing the FCPA As the Exclusive Remedy for Improper Foreign Payments

ECAT members members support enactment into law of what is reported to be the policy of the Justice Department -- i.e., to rely exclusively upon the FCPA to prosecute U.S. companies for foreign governmental bribery. Prior to enactment of the FCPA, United States law contained no express prohibition on improper payments to foreign government officials. In a number of cases that arose prior to the FCPA's enactment in 1977 but which were brought before and after that date, the Justice Department relied on exisiting criminal U.S. statutes to prosecute U.S. companies. With only one exception, these cases were the subject of plea agreements and, as a result, the courts were not asked to address whether there was a proper basis for challenging these statutes' applicability to the overseas conduct in question.

Whatever the legal merits of applying more than one statute to the same conduct, there is now a sound basis in policy for providing expressly that the FCPA alone governs when a foreign governmental bribe is subject to criminal prosecution in the United States. The wire and mail fraud statutes are, at best, blunt instruments for attacking improper overseas payments. They reflect none of the careful consideration of relevant trade and foreign policy issues which Congress addressed in 1977 during the legislative process leading to the FCPA and is currently reviewing. Moreover, there is a precedent for moving beyond the wire and mail fraud prohibitions with more explicit legislation shaped to respond to a specific problem before the

nation. This was the pattern with the response to improper practices in connection with securities transactions and interstate land sales. Initially, U.S. prosecutors relied on the mail or wire fraud statutes. Ultimately, the Congress approved specific legislation directed at these problems after a careful examination of the relevant facts.

ECAT members believe that American business is entitled to have and needs explicit guidance on what constitutes a proscribed overseas payment. When amended as proposed by S. 430, the FCPA will provide such guidance. For that reason, ECAT supports the provision of S. 430 that would make clear that the FCPA is the exclusive provision under U.S. law for civil or criminal proceedings for foreign governmental payments or actions in furtherance of such payments that are made using the mails or other means of interstate commerce.

5. Books and Records and Internal Accounting Controls

Another major area of ambiguity concerns the reach of the accounting provisions of the Act. These require an issuer to (a) "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer" and (b) "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that" specific statutory objectives are met.

S. 430 removes a great deal of uncertainty regarding the reach of the accounting provisions by applying to them a reasonableness test. It defines

reasonableness in terms of what would "satisfy prudent individuals in the conduct of their own affairs, having in mind a comparison between benefits to be obtained and costs to be incurred in obtaining such benefits." It goes to not only the "reasonable detail" of accounting records, but also the "reasonable assurances" of internal controls surrounding such records.

S. 430 would not maintain recordkeeping as a free-standing requirement of the Act. As a free-standing requirement it has been criticized repeatedly by financial executives and independent accountants as incapable of full achievement. One financial executive from an ECAT company who testified before the Committee at an earlier hearing referenced the concept of "accurate records" and said, "I can assure you there is no such animal that exists on the face of the Earth. It is impossible to have literally accurate and precise records."

S. 430 would tie the recordkeeping requirement to the purpose of achieving the statutorily specified objectives of internal accounting controls. By coordinating the recordkeeping provisions with the internal accounting control provisions, S. 430 would clarify the reach of the accounting provisions without weakening the ability of the FCPA to address successfully the problems which were identified by the Congress in 1977. Congress considered at that time that deliberate failures to maintain accurate corporate records and deliberate circumventions of internal accounting controls had contributed to the making of improper foreign payments.

It should also be noted that before enactment of the FCPA, American corporations had already begun adopting policies and procedures to prevent such improper conduct from occurring again and there is every reason to believe that these actions have satisfactorily achieved their objective. Further, and for often unrelated reasons, registered companies have since the mid-1970's moved strongly in the direction of establishing Audit Committees comprised of outside directors and strengthening internal audit departments.

6. Scienter Requirement

The absence of an express scienter requirement in the accounting section of the FCPA exposes American business to potential criminal liability for unintentional -- even inadvertent -- errors in the company's books. S. 430 would make clear that Congress intended the accounting section of the FCPA to be framed in terms of the very abuses that were revealed, i.e., knowing falsification of books and knowing circumvention of internal accounting controls. Congress did not have before it in 1977 nor does it have at present any showing of a need for imposing criminal liability for unintentional failure to meet the statute's recordkeeping and accounting standards.

7. Other Provisions of S. 430

S. 430 proposes a number of other significant improvements in the FCPA which ECAT members support. These include the amendment that defines the

good faith obligation of an issuer for the recordkeeping and internal accounting controls of a domestic or foreign firm in which the issuer holds 50 percent or less of the voting power; the exclusion expressly from the FCPA of activities, such as social gifts and routine business expenses for marketing products and services, that Congress had not intended to prohibit; the application of the FCPA to "activities in the interstate or foreign commerce of the United States"; and the strengthening of the responsiveness and confidentiality of the Business Review Procedure. We support approval by Congress of these provisions in S. 430.

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We appreciate this opportunity to present the views of ECAT members on this important legislative issue. Until S. 430 is enacted into law, American business will continue incurring the needless costs that result from the application of those provisions of the FCPA that Senator Chafee was the first to address in reform legislation. The changes proposed by S. 430 will help to eliminate the unnecessary competitive disadvantage that U.S. industry faces in enhancing American exports and foreign investment. We urge prompt and favorable action on S. 430.

Senator HEINZ. Mr. Cohen, thank you very much. Mr. Green.

STATEMENT OF ALLEN B. GREEN, PARTNER, McKENNA, CONNER & CUNEO, REPRESENTING THE PUBLIC CONTRACT LAW SECTION, AMERICAN BAR ASSOCIATION, WASHINGTON, DC, ACCOMPANIED BY JOHN PRESTON, CHAIRMAN, INTERNATIONAL PROCUREMENT COMMITTEE, PUBLIC CONTRACT SECTION

Mr. GREEN. Thank you. Mr. Chairman. My name is Allen Green, and I chair the Foreign Corrupt Practices Act work group of the International Procurement Committee within the American Bar Association's section of public contract law.

With me today is John Preston, next to Mr. Cohen, over here, who chairs the International Procurement Committee of the public contract section.

I am pleased to testify today regarding the proposal to amend the antibribery provisions of the Foreign Corrupt Practices Act, which is before the committee as section 5 of S. 430 in the Business, Accounting and Foreign Trade Simplification Act.

My remarks represent the views of the ABA section of public contract law. They have not been, I should note, approved by the ABA house of delegates or the board of governors, and accordingly, should not be construed as the position of the full American Bar Association.

CONCERN FOR LAWS AFFECTING CONTRACTS

Our section of public contract law is principally concerned with the laws and practices that affect contracts, contractors, and governments involved in the purchase and sale of goods and services for the public. As such, the section is deeply involved in U.S. public contract laws, as well as laws pertaining to public procurement in other nations. We're very interested, accordingly, in such matters as the Foreign Corrupt Practices Act.

We are submitting our views in hopes that we can contribute to the committee's ongoing efforts to improve upon the original FCPA legislation.

I want to address in particular this morning two discrete areas of the FCPA, concerning which we believe difficulties of interpretation and application have arisen. These are the "reason to know" standard for third-party payments and the approach to permissible payment or exceptions to coverage of the FCPA.

I should note that a written statement of the section has been submitted to the committee. We would like to have that made part of the record. Our written statement also addresses S. 2033 and H.R. 4800, as those bills relate to FCPA amendment.

Senator HEINZ. Without objection, your full statement will be a part of the record.

Mr. GREEN. Thank you, sir. I will attempt to summarize our views here, of course, with particular regard to S. 430.

The FCPA has been a source controversy since it was first passed. Everyone has agreed that its goals are admirable. In its present form, however, it presents the possibility of unnecessarily criminalizing mundane, straightforward foreign dealings involving no intent to bribe or direct knowledge of bribery and giving rise to

criminal liability, unnecessarily. The section advocates development of improved standards and definitions, whereby transactions in the normal course of business, which are not intended to corruptly influence the contracting decisions of a foreign government, be clearly exempted from FCPA liability.

Let me turn to the issue of third-party payments. We believe there is a strong need to clarify the standard of criminal culpability for illegal third-party statements. The current reason to know standard, from a lawyer's viewpoint, is ambiguous. It has never been defined. It is not a normal criminal standard, and judges do not necessarily know what it means. Indeed, Justice does not enforce us on that basis. It is imperative, we believe, and the Constitution requires, a criminal statute to precisely define the offense.

Now it has been suggested that without the reason to know standard, and given the difficulty of detecting bribery in another nation, businessmen can merely close their eyes to the activities of their agents. However, it is well settled that a straight forward knowledge standard—use of the word "knowing" in this statute without the ancillary phrase "reason to know"—will impute criminal liability to those who act with conscious disregard or deliberate ignorance of the truth. That is clearly the case law and in the judge's instructions to juries. It is also the approach used by the model Penal Code in defining "knowingly" as a criminal standard.

Further, I should note, the "reason to know" standard imposes criminal liability on activity abroad that is not criminal within the United States. The domestic bribery statute has no "reason to know" standard for imputing criminal or civil liability. Accordingly, unlike the domestic bribery statute, the "reason to know" standard for third-party payments potentially criminalizes negligent or even innocent, as opposed to intentional or knowing conduct.

PROPOSAL TO REPLACE "REASON TO KNOW"

Now before the committee under S. 430 we have a proposal to replace the "reason to know" language in third-party payments with language that would make it unlawful, corruptly, to direct or authorize, expressly or by a course of conduct, a third party in furtherance of a payment, and so forth, that was made for prohibited purposes, that is, to obtain or retain business, as stated in an earlier section.

Now this language would require proof that a U.S. person directed or authorized by explicit acts or a course of conduct, a third party's actions in furtherance of an illegal payment.

The direct or authorized language certainly suggests a more active involvement by U.S. companies, coincident with criminal culpability, than the "reason to know" standard. And we believe that this language is an improvement over the "reason to know" standard of the FCPA; however, we respectfully suggest that this language is not definitive enough to overcome the problems that I previously described. It would add a new set, potentially, of ambiguities in determining what constitutes directing or authorizing an act or, in particular, what constitutes a course of conduct.

As with the "reason to know" standard, this novel language, untested by and potentially unknown to the courts, could produce un-

certainty as to what the law means. Accordingly, we suggest replacing the "reason to know" standard with a straightforward knowledge standard that will preserve the deterrent against deliberate efforts to ignore the possibility of corporate bribery abroad through third-party intermediaries and capture deliberate ignorance or "head in the sand" conduct. At the same time, it will avoid criminalizing innocent or negligent conduct and will establish a commonly accepted, clearly understood standard defined by the courts and the model Penal Code, under which we can give guidance.

Let me now turn, briefly, to the issue of permissible payments or exceptions to coverage of the act. The idea, I believe, behind exceptions to the coverage of the act, has been that certain payments clearly not intended to be bribes to obtain business are necessary to do business overseas, and they should be removed from coverage of the act, and this will help eliminate the uncertainty we've seen in the last few years in enforcement of and adhering to the act.

Now the FCPA, at present, does not expressly identify permissible payments, except by indirectly excluding from the definition of foreign officials, those whose duties are ministerial, not discretionary. The legislative history states the proposition more clearly by declaring Congress' intention not to prohibit so-called facilitating payments. And the purpose of the distinction was to separate those acts with a purpose other than influencing an official's action to obtain or retain business.

S. 430, of course, lists several types of payment which would be declared expressly legal, including facilitating or grease payments, payments lawful under the laws of the country and other express exemptions. We support those exemptions. We note—we add—that while such exclusions would resolve certain real and oft-encountered situations, we believe that there is a more fundamental method of addressing the issue. We believe that the FCPA should be amended to require as one element of the offense, a specific intent that an illegal payment be intended as a bribe. Thus, for example, a defendant must know that the payment to a third party—and that incorporates the notion of deliberate ignorance—will be transferred to a foreign public official, and he must intend that the payment to the foreign official be made to obtain or retain business.

We offer this proposal as an alternative or a complement to a listing of permissible payments in the FCPA, which may never be sufficient to cover all future, otherwise proper payments, and which will continually lead to the sort of dialog, perhaps, that we've been having this morning, with regard to the proper definition of those exceptions.

By amending the FCPA to require specific intent to bribe, the statute, we believe, would serve its intended, its original, principal purpose, to prosecute corrupt payments, whether large or small and whether offered to a dock supervisor or a head of state. It is the civil or criminal intent, we would suggest, of the person offering the bribe, which is customarily the thrust of the criminal law, and not the amount of the bribe, that should be the basis, we believe, for imposing criminal liability.

Now I would like to note in closing that I have focused this morning—and indeed, we have focused in our written statement on, primarily, the "reason to know" problem and this issue of the exemption to coverage of the act and how we suggest it might be approached.

Certainly, we are concerned, for example, with the issues raised with regard to the accounting standards section and others, but we have tried to focus our thoughts this morning.

I would like to thank you for the opportunity to testify before you today and, of course, would be pleased to answer any questions.

[The complete prepared statement follows:]

STATEMENT
OF
ALLEN B. GREEN

CHAIRMAN,
FOREIGN CORRUPT PRACTICES ACT WORKING GROUP

INTERNATIONAL PROCUREMENT COMMITTEE

SECTION OF PUBLIC CONTRACT LAW

AMERICAN BAR ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY AND THE
SUBCOMMITTEE ON SECURITIES

OF THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

JUNE 10, 1986

Statement of the
Section of Public Contract Law
American Bar Association

Before the Subcommittee on International Finance
and Monetary Policy and the Subcommittee on Securities

of the

Senate Committee on Banking, Housing,
and Urban Affairs

INTRODUCTION

The Section of Public Contract Law of the American Bar Association ("ABA") is pleased to have the opportunity to submit a Statement on amending the Foreign Corrupt Practices Act of 1977. This Statement represents the views of the Section but has not been approved by the House of Delegates or Board of Governors of the ABA. As such, it represents only the position of the Section of Public Contract Law and should not be construed as representing the position of the American Bar Association.

The Section of Public Contract Law is principally concerned with the laws and practices affecting contracts, contractors and governments involved in the purchase and sale of goods and services for the public. The Section is interested in United States public contract law, as well as laws pertaining to public procurement in other nations. As such, our membership is deeply

interested in such matters as the Foreign Corrupt Practices Act of 1977 (hereinafter referred to as the "FCPA").[1/]

Currently the Committee has before it S. 430, the Business Accounting and Foreign Trade Simplification Act, which suggests certain changes to the FCPA and the manner in which it is administered. The Section of Public Contract Law believes there are serious questions of law extant as to the constitutionality, enforceability and administration of certain provisions of the FCPA as those provisions now exist. Accordingly, the Section is furnishing its views regarding the legality and desirability of portions of the FCPA under study by your Committee, and on current proposals to amend the statute. In so doing the Section does not take any position regarding the need or desirability of the FCPA, inasmuch as that matter has properly been decided by Congress and the Executive. Rather, our comments will address two principal areas of the FCPA which raise legal questions -- "the reason to know" standard for third party payments, and the definition of permissible payments.

SUMMARY

We believe there is a strong need to clarify the standard of criminal culpability for illegal third party payments. The "reason to know" standard, currently found in the FCPA, is both ambiguous and unwarranted. United States businessmen have been

1/ 15 U.S.C. §§ 78m, 78dd-1, 78dd-2, 78ff (1982).

deterred from seeking legitimate business opportunities abroad because of the ambiguity surrounding this standard; this has resulted in less aggressive marketing of U.S. products abroad and has contributed to the nation's staggering trade deficit. Second, the "reason to know" standard imposes criminal penalties for negligent conduct, and is therefore inconsistent with modern notions of criminal justice. The Department of Justice has expressed its dissatisfaction with this standard as a workable and fair tool for prosecuting criminal conduct. Third, the legal standard for criminal prosecution is so vague and inappropriate when applied in the context of activities occurring in a foreign territory, where local customs are quite unfamiliar to U.S. society, that the "reason to know" standard borders on being unconstitutional.

Therefore, the Section supports the notion of replacing the "reason to know" standard for illegal third party payments with an "actual knowledge" standard. The Section believes this will assist prosecutors in the exercise of their discretion and enforcement efforts, and at the same time clarify for U.S. businessmen their responsibility to avoid criminal conduct. The Section does not believe that an "actual knowledge" standard will encourage a "head in the sand" approach to doing business abroad because the modern and generally accepted (by the courts) notion of "knowledge" encompasses the concept of "willful blindness" in order to avoid actual knowledge. In this regard, the Section

opposes the effort undertaken by the House in H.R. 4800 to define the "knowledge" standard since it misinterprets and misapplies the generally accepted standard found in the Model Penal Code. We believe the courts are most able and willing, in light of a long line of existing precedent, to charge juries with the appropriate definition of "knowledge" in order to accommodate the facts and circumstances of each individual case. If a definition of "knowledge" is considered necessary, then we would recommend the definition found in the Model Penal Code, which represents extensive legal research and analysis of the subject, and which would criminalize "willful blindness" but not acts of negligence or inadvertence.

Second, the Section believes that the FCPA should be amended to require specific intent that an illegal payment was intended as a bribe. The Section offers this proposal as an alternative or complement to a listing of "permissible payments" in the FCPA, which may never be sufficient to cover all legitimate payments. By amending the FCPA to require a specific intent to bribe, the statute will serve its principal purpose -- to prosecute corrupt payments, whether large or small and whether offered to a dock supervisor or a head of state. It is the civil or criminal intent of the person offering the bribe, not the amount or recipient of the bribe, that should be the basis for imposing criminal liability.

Finally, the Section observes that the House proposes to add new language to the FCPA to the effect that efforts to obtain favorable legislative, judicial or regulatory action in a foreign territory can fall within the scope of the prohibition. The Section is concerned with this language because it would appear to prohibit, inter alia, lobbying and other activities clearly permissible under local law, and would urge further study of this issue before any action is taken.

ANALYSIS

Overview

Any effort to amend the Foreign Corrupt Practices Act ("FCPA") must begin with an understanding of the initial policy considerations that motivated U.S. lawmakers to enact the statute. Essentially, the FCPA was born of revelations that a number of U.S. companies had made significant payments to foreign officials for the purpose of securing lucrative business opportunities. SEC investigations conducted in the 1970's revealed that over 300 U.S. companies had engaged in "corrupt" foreign payments involving hundreds of millions of dollars. Countries that were, and remain, U.S. allies -- such as Japan, Italy and the Netherlands -- were identified as countries where foreign payments had been made. Congress and Administration officials determined that the revelation of such activities had caused adverse foreign policy consequences for the United States and that such action was inconsistent with basic U.S. economic

principles. One congressional report succinctly summarized the considerations that led to the enactment of the FCPA:

> Foreign governments friendly to the United States in Japan, Italy and the Netherlands have come under intense pressure from their own people. The image of American democracy abroad has been tarnished. Confidence in the financial integrity of our corporations has been impaired. The efficient functioning of our capital markets has been hampered.
>
> Corporate bribery is bad business. In our free market system it is basic that the sale of products should take place on the basis of price, quality, and service. Corporate bribery is fundamentally destructive of this basic tenet. . . . Secretary of the Treasury Blumenthal, in appearing before the committee in support of the criminalization of foreign corporate bribery testified that: "Paying bribes -- apart from being morally repugnant and illegal in most countries -- is simply not necessary for the successful conduct of business here or overseas."

See House Report No. 95-114, reprinted in 123 Cong. Rec. 13820 (May 5, 1977).

However, since the enactment of the FCPA there have been a number of criticisms, many focusing on the competitive effect of the FCPA on U.S. companies trying to compete with foreign companies for business in third country markets. Today, these criticisms may be even more poignant. Recent years have revealed record U.S. trade deficits, and a number of studies have indicated that U.S. competitiveness in the world market has declined, in part due to "over-regulation" by the U.S. government.

On March 4, 1981, the General Accounting Office ("GAO"), published a report to Congress entitled "Impact of Foreign Corrupt Practices Act on U.S. Business." The report was based upon a GAO survey of 250 companies randomly selected from the Fortune 1000 list of the largest U.S. industrial firms. Approximately 75% of the 250 companies responded, and thirty percent said that they had lost overseas business as a result of the FCPA. In short, United States companies lose business in attempting to ensure compliance with this vague criminal statute.

Congressional testimony later in 1981 reinforced the results of the GAO study. The Emergency Committee for American Trade ("ECAT") stated that "[N]o provision of the FCPA has caused American business greater problems than that prohibiting payments to 'any person, while knowing or having reason to know' that a foreign official will ultimately receive the payment."2/ According to ECAT testimony, the ambiguity of the "reason to know" provision had deterred U.S. exporters from developing legitimate potential markets abroad.

Nonetheless, in the Section's opinion, the presence or absence of a competitive effect is not the key issue in considering amendments to the FCPA. Indeed, the results of the

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2/ Statement of the Emergency Committee on American Trade before the Subcommittee on International Finance and the Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, on Bill S.709, Proposed Amendments to the Foreign Corrupt Practices Act of 1977 (May 21, 1981).

GAO survey would suggest that the FCPA has had a corrective effect on U.S. business practices. Bribery should be condemned as a means of conducting business. If business is lost because bribery is curtailed, Congress has deemed that an acceptable cost for promoting lawful conduct. Nevertheless, the general consensus is that certain aspects of the FCPA have resulted in unnecessary business losses and have created considerable apprehension among U.S. businessmen when dealing in foreign markets. The clear purpose of the FCPA should be to criminalize deliberate furtherance of foreign bribery. We advocate only a greater certainty in the law so that lawful conduct will not be deterred.

REASON TO KNOW

Background

The FCPA anti-bribery provisions prohibit "issuers" and "domestic concerns" from corruptly using any means of interstate or foreign commerce in furtherance of an offer, payment, promise to pay or gift to a foreign official or political party for the purpose of assisting in obtaining or retaining business for or with, or directing business to, any person. Apart from prohibiting U.S. persons or companies from directly engaging in the commercial bribery of foreign officials, the FCPA goes one step further. It prohibits U.S. persons and companies from offering or paying anything of value to "any person [e.g., agents or third parties], while knowing or having reason to know that all or a

portion of such money or thing of value will be offered, given, or promised, directly or indirectly" to a foreign official for an unlawful purpose.

Since the enactment of the FCPA, the "reason to know" standard for imputing liability to a U.S. person or company based on the actions of a third party has been the subject of considerable attention and debate. Supporters have urged that without such a standard the entire FCPA would be impaired as businessmen merely "closed their eyes" to the activities of their agents abroad and accordingly passively permit bribery. In addition, this language was thought to serve a perceived need for "self-policing" by U.S. companies. The U.S. government, in the process of allocating scarce resources, could only be expected to discover and prosecute a small percentage of foreign bribes. The very fact that the activity occurred abroad posed particular problems for government enforcement activity. Including a "reason to know" standard, it was believed, would tend to create an incentive for sorely needed self-policing.

Opponents have argued that "reason to know" is ambiguous, inappropriate and anomalous, and has caused U.S. companies to lose business abroad out of an overabundance of caution. Moreover, opponents state the FCPA was not intended as a worldwide code of business ethics. Indeed, most countries around the world have laws on the books condemning bribery of government officials. Given the limited resources of U.S. enforcement

authorities and the practical and legal obstacles to U.S. officials investigating activities abroad (including traditional notions of sovereignty), the chief responsibility for detecting and prosecuting illegal payments should be left with local authorities in the host country. While the Section agrees that intentional bribery must be condemned, the self-policing inspired by the "reason to know" standard takes the effect of the FCPA too far into the legal domain of other sovereign nations.

A further criticism of the FCPA focusses upon the fact that the U.S. domestic bribery statute does not have a "reason to know" standard for imputing criminal or civil liability.[3/] Some commentators have suggested that it is unfair and inappropriate to impose a standard for regulating foreign activity that has not been adopted in regulating activities within our own country. No doubt the "reason to know" standard may facilitate enforcement efforts because it hinges liability on the knowledge of U.S. persons rather than the conduct of foreign agents,[4/] and there is admittedly no general constitutional bar to incorporating into a criminal statute a standard of culpability that facilitates enforcement of the underlying policy. See United States v.

3/ See 18 U.S.C. § 201(b) (1982).

4/ See Fedders, "'The Reason to Know' Standard - A Troublesome Ambiguity in the U.S. Foreign Corrupt Practices Act," Middle East Executive Reports, No. 7, p. 24, n. 13 (July 1981).

Krause, 484 F.2d 549, 551 (7th Cir. 1973) (court construes "reasonable cause to believe" language in federal firearms statute). However, facilitating enforcement must be distinguished from criminalizing potentially innocent or negligent conduct. Where the scope of criminal liability imposed by a statute is ambiguous and the spectrum of prohibited activities is highly uncertain, then the risk of prosecuting inadvertent conduct or unwitting actors under the "reason to know" formula is drastically increased. The courts have clearly stated that the purpose or effect of "reason to know" language should not be to criminalize inadvertent or even negligent conduct. See United States v. Featherston, 461 F.2d 1119, 1122 (5th Cir. 1973), cert. denied, 409 U.S. 991 (1974) (court interprets "reason to know" language in 18 U.S.C. § 231(a)(1)); United States v. Banks, 368 F. Supp. 1245, 1247 (D.S.D. 1973) (same). The effect of the uncertainty in application of the "reason to know" standard is that we of the Section cannot advise our clients that such conduct will be treated any less harshly than intentional bribery, which has the natural effect of discouraging international transactions.

Notably, the chief enforcement arm of the U.S. government -- the Department of Justice -- views the "reason to know" standard as an inappropriate and harsh standard for criminal

prosecution. In a July 1982 memorandum to the staff of the House Committee on Energy and Commerce, Deputy Attorney General Edward Schmults stated:

> In the Department of Justice's estimation, the "reason to know" standard of the current law is plainly inappropriate. It is harsh and inconsistent with the general approach of modern criminal law to state of mind requirements.

This criticism is based on a number of observations. According to the Justice Department, "all that 'reason to know' requires is (1) a risk that a person of ordinary intelligence would perceive, where (2) disregard of that risk would involve a departure from reasonable care." In other words, negligent behavior can result in criminal liability. In light of U.S. legal tradition regarding the degree of culpability needed for serious felony offenses, this standard represents a deviation from the norm. The American Law Institute's Model Penal Code, which is the basis for many state penal codes, recognizes only four degrees of criminal culpability -- specific intent, knowledge, recklessness and negligence. "Negligence," even of a gross character, is typically not used as a standard for criminal liability. Rather, "recklessness or higher degrees of culpability (knowledge or intent) are routinely required in relation to the elements of criminal offenses."[5/] Yet "reason to know" is a

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5/ See Memorandum of Edward C. Schmults, Deputy Attorney General, to Staff of the Energy and Commerce Committee of the United States House of Representatives, on Standards (Continued)

state of mind more easily satisfied than the criminal negligence standard in the Code.[6/] Indeed, in the Justice Department's view, "all that 'reason to know' requires in the foreign bribery context is a payment to an agent where a person of ordinary intelligence would perceive a risk of the agent's making an illicit payment the disregard of which would constitute simple negligence. There is no requirement that the payer actually apprehend that there is a risk of an illicit payment being made or that the departure from reasonable care involved in the disregard of such a risk must be to any degree extreme."[7/]

In response, some have pointed out that the "reason to know" standard, as a measure of criminal culpability, is not unique to the FCPA. A number of other statutes (29 have been

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Governing Payments Through Intermediaries in the Foreign Bribery Law (July 26, 1982), p. 4.

6/ "Reason to know" will be satisfied where the surrounding circumstances of an alleged violation suggest that a reasonable man could have inferred the existence of the violation despite the actual subjective knowledge, intelligence, or perception of the one charged. According to one former enforcement official, the "reason to know" standard is different than the "should have known" standard which connotes an initial duty to ascertain facts and an obligation to exercise due diligence. See Fedders, "The 'Reason to Know' Standard," supra, at p. 20.

7/ See supra, note 5.

identified in the literature)[8] have adopted similar language. But according to an SEC analysis, 13 of the 29 are enforceable only by civil or administrative sanctions.[9] Of the remaining 16, 6[10] fall in the areas of safety standards and misdemeanor liability, and 8[11] are found in the current federal criminal code (Title 18) and would be amended by proposed revisions to the criminal code. The remaining 2 impose criminal liability for illegal electronic surveillance and disclosure of classified information to foreign agents.[12] One such provision would be repealed by the criminal code revisions.

The maintenance of a "reason to know" standard in the FCPA for third-party payments is inconsistent with U.S. laws applied in a domestic context, represents a departure from current legal theories of criminal culpability, and would represent an anomaly in the current move to reform federal criminal law. Moreover,

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8/ See Fedders, "The 'Reason to Know' Standard," supra, p. 24, n. 14.

9/ Id., citing 15 U.S.C. §§ 714, 1397(a)(1)(C), 1397(b)(2), 1692(a)(3), 1916(a)(4); 25 U.S.C. § 1912(a); 26 U.S.C. §§ 6013(e), 6323(i); 29 U.S.C. § 1343(a); 42 U.S.C. §§ 253j(a)(5), 1320a-7a(a)(1)(A); 46 U.S.C. § 1461(b); 49 U.S.C. § 11901(i)(4)(B)(ii). Several of these sections have been superseded since publication of this analysis.

10/ See 15 U.S.C. §§ 1916(b)(2), 2068(a)(6), 2614(2); 26 U.S.C. § 999(a); 42 U.S.C. §§ 5409(a)(4), 5409(b)(2).

11/ See 18 U.S.C. §§ 231, 1384, 2251(a), 2251(b), 2423(a)(2), 2511(1), 2512(1), 2512(2)(b).

12/ See 50 U.S.C. §§ 783(b), 1809(a)(2).

the "reason to know" standard is a situationally-determined legal standard which, as a measure for imposing criminal liability on a corporation or executive management for activities of third parties operating in foreign territories, is so vague that it may raise constitutional concerns. See, e.g., Kolender v. Lawson, 461 U.S. 352 (1983), in which the court held that the void-for-vagueness doctrine requires that a penal statute define a criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited.

Legislative Proposals

In 1981, Senator John Chafee introduced S. 708 -- the "Business Accounting and Trade Simplification Act" -- to amend the FCPA. S. 708 would have replaced the "reason to know" standard with a provision requiring proof, direct or circumstantial, that a company had "directed or authorized" a third party to make a corrupt payment. The proposed language of S. 708 relating to third party payments was as follows:

> It shall be unlawful for any domestic concern, or any officer, director or employee, or shareholder thereof acting on behalf of such domestic concern to make use of the mails or any means or instrumentality of interstate commerce corruptly to direct or authorize, expressly or by a course of conduct, a third party in furtherance of a payment, gift, offer or promise of anything

of value to a foreign official for any of the purposes set forth in subsection (a).[13]

This language would have required proof that a U.S. person directed or authorized, by explicit acts or a course of conduct, a third party's actions in furtherance of an illegal payment. The "direct or authorize" language suggested a more active involvement by the U.S. company than "reason to know," in order to impute criminal culpability. The "course of conduct" phrase was intended to capture instances where a U.S. company had a basis for believing that an agent had engaged in illegal payments, but had ignored that belief and continued to employ the agent. The Administration generally endorsed these changes.[14]

On March 16, 1983, Representative Mica introduced the Foreign Trade Practices Act of 1983 -- H.R. 2157 -- which would have amended the Export Administration Act and added a provision regarding foreign payments that read:

> It shall be unlawful for any United States person, or any officer, director, employee, or stockholder thereof acting on behalf of such United States person, acting

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13/ This same language in essence appeared in S. 414 -- the "Business Accounting and Foreign Trade Simplification Act" - which was introduced on February 3, 1983, by Senators Heinz, Chafee, Garn, D'Amato and Goldwater; and in S. 1860 -- the "Trade Enhancement Act of 1985" which was introduced on November 20, 1985 by Senator Danforth.

14/ See Testimony of U.S. Trade Representative William E. Brock before a joint hearing of the Subcommittee on International Finance and Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs (May 20, 1981).

> in the interstate or foreign commerce of the United States, corruptly to direct or authorize, expressly or by a course of conduct, a third party to offer, pay, promise, or give anything of value --
>
> (A) to any foreign official for any purpose set forth in paragraph (1)(A), or
>
> (B) to any foreign political party or official thereof or any candidate for foreign political office for any purpose set forth in paragraph (1)(B).

This legislation would have maintained the language "direct or authorize, expressly or by a course of conduct," but would have eliminated the ambiguous "in furtherance" language contained in S. 708.

On February 2, 1985, Senators Heinz, Chafee, Garn and D'Amato introduced S. 430 -- the "Business Accounting and Foreign Trade Simplification Act." This bill was originally introduced as S. 708 in 1981, contains the same language regarding third-party payments, and has also been incorporated in S. 1860, which was introduced by Senator Danforth on November 20, 1985. The Section believes that the language of S. 430 is a distinct improvement over the "reason to know" standard of the present FCPA. However, we would suggest that even this language is not definitive enough to overcome the criticisms outlined above. It would add a new set of ambiguities concerning the meaning of "direct," "authorize," and "course of conduct."

On January 30, 1986, Senator Chiles introduced S. 2033, known as the "Trade Expansion Act of 1986." This legislation contains language amending the FCPA, eliminating the reason to know standard and adding the following language in lieu thereof:

> (2) It shall be unlawful for any United States person, or any officer, director, employee, or stockholder thereof acting on behalf of such United States person, to act in the interstate or foreign commerce of the United States, with knowledge that a third party will offer, pay, promise or give anything of value --
>
> (A) to any foreign official for any purpose set forth in paragraph (1)(A), or
>
> (B) to any foreign political party or official thereof or any candidate for foreign political office for any purpose set forth in paragraph (1)(B).

A similar bill was introduced in the House of Representatives the same day by Representative Dan Mica as H.R. 4093.15/

The Section of Public Contract Law supports the adoption of the actual knowledge language proposed in S. 2033 in order to impose criminal liability. This language eliminates the ambiguity and the vagueness contained in the current FCPA which has

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15/ On March 13, 1986, Representative Mica introduced the same language from H.R. 4093, along with the other provisions amending the FCPA, as the Foreign Trade Practices Act, H.R. 4389. On May 22, 1986, the House enacted a set of amendments to its omnibus trade bill, H.R. 4800, including FCPA language, which made substantial changes in the "reason to know" standard and prior legislative proposals to amend that standard. See discussion, infra.

raised a number of practical and legal questions, as discussed above. Moreover, such a requirement is consistent with modern notions of criminal culpability. Likewise, it avoids the potential reintroduction of ambiguity associated with the language of S. 430 -- "directing or authorizing, expressly or by course of conduct." For example, the language of S. 430 does not indicate what level of involvement would constitute "directing or authorizing;" moreover, how long or palpable must a course of conduct" be in order to impute actual knowledge? These standards are both vague and novel to the courts. The Section believes that by adopting a standard based upon knowledge, the statute would permit law enforcement authorities to draw upon the existing and substantial body of judicial precedent defining actual "knowledge." The existing notion of "knowledge" under the criminal law encompasses "deliberate ignorance" and is sufficient to deter the "head in the sand" approach to foreign corporate bribery, and therefore better-suited than the "reason to know" standard found in the current FCPA.

There is a substantial body of precedent imputing criminal liability under a knowledge standard to those who act with conscious disregard or deliberate ignorance of the truth. See, e.g., United States v. White, 765 F.2d 1469 (11th Cir. 1985) (construing 18 U.S.C. §§ 287 and 1001); United States v. Dick, 744 F.2d 546 (7th Cir. 1985) (construing 18 U.S.C. § 1341). In

holding that "deliberate ignorance," in order to avoid knowledge of a violation, is encompassed by the knowledge standard, the Court in United States v. Restrepo-Granda, 575 F.2d 524, 528 (5th Cir.), cert. denied, 439 U.S. 935 (1978), defined deliberate ignorance to denote:

> a conscious effort to avoid positive knowledge of a fact which is an element of an offense charged, the defendant choosing to remain ignorant so he can plead lack of positive knowledge in the event he should be caught.

Therefore, clarifying the degree of criminal culpability by replacing the "reason to know" standard with a "knowledge" standard will preserve the deterrent against deliberate efforts to ignore the existence of corporate bribery abroad through third party intermediaries. At the same time, it will avoid criminalizing innocent or negligent conduct, and remove a substandard obstacle to aggressive marketing of U.S. goods in foreign markets.

House Proposal H.R. 4800

At this point, it is appropriate to comment on H.R. 4800 and the proposed language passed by the House. H.R. 4800 established a two-prong standard distinguishing between criminal and civil liability. Other statutes have taken this approach, thereby allowing civil enforcement action to be taken against activities that do not rise to the level of criminal culpability.

However, the Section does not believe that the House effort to define, in a detailed way, the standard of criminal culpability is either necessary or proper. As noted above, the definition of a criminal standard is a task properly relegated to the courts for their instructions to the juries. This permits the court flexibility in determining the appropriate jury charge to fit the factual circumstances of a case. Superimposing detailed definitions of criminal culpability through a federal statute may not only restrict judges in the performance of their responsibilities, but it may create unnecessary confusion in light of the existing body of case law on standards of criminal culpability and knowledge. This may be all the more true in the context of the FCPA, where courts must have flexibility to charge jurors with a definition of knowledge appropriate to the analysis of activities that occur in foreign territories under circumstances that may be quite different from U.S. customs and social mores.

Even more important, the actual language of H.R. 4800 represents a significant departure from the notions of criminal culpability as reflected in the Model Penal Code. H.R. 4800 replaces the "reason to know" standard for corrupt third party payments with two standards -- "knowledge" and "reckless disregard" of an illegal third party payment. Specifically, proposed sections 30A(a) and 104 of H.R. 4800 make it unlawful to

offer anything of value to "any person, while knowing or recklessly disregarding that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to any foreign official . . . [for the purpose of influencing his action in order to obtain or retain business]." According to Sections 30A(b) and 104(f), a violation based on "knowledge" is a criminal offense, while one based on "reckless disregard" is subject to civil liability.

Up to this point, H.R. 4800 represents a laudable attempt to clarify the existing FCPA and implement a workable enforcement mechanism. However, H.R. 4800 goes awry of modern notions of criminal and civil culpability when defining the "knowing" and "reckless disregard" standards. Despite the effort to avoid imposing criminal liability for reckless actions, H.R. 4800's definition of "knowledge" in fact reintroduces the notion of recklessness along with a hybrid concept of imputed knowledge. Thus, the proposal is both inconsistent with its own legislative intent and modern criminal law.

For purposes of a "knowing" violation (and therefore criminal culpability), H.R. 4800 states that a person meets the knowing standard if:

> "(A) that person is aware or substantially certain, or
>
> (B) that person is aware of a high probability, which he or she consciously disregards in order to avoid awareness or substantial certainty, and does not have an actual belief to the contrary,
>
> that a third person [will make an illegal payment]."

In this fashion, a definition of "knowing," if indeed one is required, appears intended to parallel the Model Penal Code, which is generally accepted as the leading authority on questions of the structure of criminal statutes. Thus, subsection (A) would impose criminal liability if an individual has actual knowledge or a substantial certainty that an illegal third party payment will occur. As noted below, this is consistent with the Code.

However, subsection (B) would go on to impute criminal liability for the conscious disregard of a high probability of the illegal payment, allegedly in an effort to deter the "head in the sand" approach. The Section believes that this standard, apparently based upon the Section 2.02 of the Code, constitutes a misinterpretation of the Code's guidance, and improperly infuses the "knowing" standard with an element of "recklessness" that the legislative history of H.R. 4800 indicates was intended only for civil prosecutions. Moreover, it is not necessary to deter the "head in the sand" syndrome in this fashion.

According to Section 2.02(2)(b) of the Code, whether one has "knowledge" of an element for purposes of criminal liability depends upon the nature of that element of the offense. If the

element involves the nature of the person's conduct (e.g., a direct payment to a foreign official), then a "knowing" violation requires actual awareness of the illegal payment. However, if the element involves the result of the person's conduct (e.g., a payment to a third party that results in a subsequent illegal payment), then a "knowing" violation can occur if he is "practically certain" that it will result in an illegal payment. Therefore, the "knowing" standard of the Code, as applied to illegal third party payments, should be based upon either actual "knowledge" (from a subjective point of view) or "practical certainty" (from an objective point of view) of an eventual illegal payment. Such a standard effectuates the policy against a "head in the sand" approach by allowing a trier of fact to determine, based upon objective fact, whether the offender had a practical certainty, at the time of his payment to an agent, that a subsequent illegal payment would occur.

Subsection (B) of H.R. 4800, however, improperly and unintentionally extends this standard by (1) borrowing from the "reckless" standard enunciated by the Model Penal Code, and (2) incorporating within that lower standard a definition of "knowledge" that the Code limits to circumstances other than those presented by the third party payment scenario of the FCPA. Specifically, the section 2.02(2)(c) definition of "recklessly" is

based upon a "conscious disregard" of a risk. H.R. 4800 incorporates the "conscious disregard" language into the knowing standard, even though the legislative history states that only civil liability was intended. It then goes on to adopt the "high probability" language found in section 2.02(7) of the Code regarding the existence of a particular fact, although the 2.02(7) language is limited to situations where knowledge of a material fact is imputed to an actor, not where knowledge of the criminal act itself is to be imputed.16/ Therefore, to be consistent with the Code and the legislative intent, the language in H.R. 4800 should be changed so as to eliminate subsection 30A(f)(2)(B) and to reword subsection 30A(f)(2)(A) to read:

> "that person is aware or is practically certain [that an illegal third party payment will occur]."

16/ As an example, suppose at midnight one evening a man places a time bomb in an empty bus station locker and sets the timer to go off at noon. The bomb goes off and kills ten individuals. In a prosecution for first degree murder, the prosecution may not be able to show that the defendant had either actual knowledge or a practical certainty that the bus station would be crowded at noon the next day. However, since a material element of the crime is establishing the defendant's knowledge that individuals would be in the bus station (thereby addressing his intent to kill), then the Model Penal Code permits evidence of the person's awareness of a "high probability" that the bus station would be crowded at noon. But this is only to show knowledge of a material fact, not knowledge of the criminal act itself -- i.e., the illegal third party payment in the context of the FCPA. Knowledge of the criminal act, according to the Model Penal Code, can only be based on actual knowledge or practical certainty. See Section 2.02(2)(b).

In this fashion, a definition of "knowing," if indeed one is required, would correctly parallel the Model Penal Code.

Likewise, H.R. 4800 professes not to impose civil liability for negligent conduct but contains language the usual definition of which would impose such liability. See 132 Cong. Rec. H.2991 (daily ed. May 20, 1986) (joint statement of Representatives Dingell and Wirth) ("The statutory change makes it clear that mere negligence will not give rise to a civil prosecution under the FCPA"). However, subsection 30A(f) imposes civil liability on anyone who disregards a "substantial risk" of an illegal third party payment. "Substantial risk" is defined to mean a risk that, if disregarded, "constitutes a substantial deviation from the standard of care that a reasonable person would exercise in such a situation." The Model Penal Code states that a person is negligent if he should be aware of a risk that, if he fails to perceive it, would involve a "gross deviation from the standard of care that a reasonable person would observe in the situation." Thus, although H.R. 4800 seemingly requires actual awareness of a substantial risk, it interjects the objective "reason to know" standard for negligence from the Code in defining the nature of the risk. The Section believes that this mixing of the Model Penal Code standards creates unnecessary ambiguity and suggests an unintended return to the "reason to know" standard for prosecuting merely negligent conduct. The Section suggests that the

Senate not adopt the language of Section 30A(f)(4) in H.R. 4800, in deference to the judiciary's duty to charge juries on the appropriate definition of "substantial risk" as determined by the circumstances of each case.

PERMISSIBLE PAYMENTS

The current proposal before the Committee, as well as previously proposed amendments to the FCPA, enumerate the types of payments that are permissible or excluded from the proscription of the FCPA. The common thread among the many proposed exclusions is that they would appear to have a purpose other than influencing an official's action to obtain or retain business; are so-called "grease payments"; or are legal in the country. Other such logical exclusions may well exist

While such exclusions are appealing as the means to resolve particular encountered situations, the Section of Public Contract Law does not believe that this is the best method of addressing the issue. This places Congress in the position of condemning bribery on the one hand while listing numerous exceptions to the rule on the other hand. Equally, it leads to ambiguity as to the purpose and intent of the Act itself and to questions of its legal enforceability. There is also a substantial risk that the administration of these provisions of the FCPA may be uneven, unsure and arbitrary.

To clarify the coverage of the Act yet avoid the necessity of listing numerous exceptions, we recommend that the Act be amended to require that a payment be made with the specific intent to obtain or retain business by corruptly influencing an official act. This could be accomplished by including the terms "offer," "payment," "promise to pay," and "authorization of the payment" in a definition section, and by simply substituting "with the specific intent to" for the present wording, "for purposes of." The operative language in S. 430, for example, would require that the words "for the purpose of" in the proposed sections 104(a) and (b) of the Business Practices and Records Act be replaced by the words "with the specific intent to." Such an amendment would give the FCPA the same coverage as the federal bribery statute, 18 U.S.C. § 201. While section 201 has no specific intent language, the courts have read the statute to require a finding of specific intent for conviction. For example, in United States v. Arthur, 544 F.2d 730 (4th Cir. 1976) the court stated that "bribery occurs only if the gift is coupled with a particular criminal intent. . . . 'Bribery' imports the notion of some more or less specific quid pro quo for which the gift or contribution is offered or accepted." See also United States v. Head, 641 F.2d 174 (4th Cir. 1981); United States v. Johnson, 621 F.2d 1073 (10th Cir. 1980). It would, of course, still be possible to establish that a trip paid for by an

American company taken by an official of a foreign government to inspect the product was paid "with the specific intent" to influence his official action, while payments which are legal in the foreign nation or are necessary to obtain ministerial services not associated with obtaining business would lack the requisite intent.

The Section does not believe it proper to categorize what are properly viewed as exceptions to the definition of corrupt payment as "defenses" to be proven by a defendant. If the listing of exempt payments is to be used, the Section favors the formulation of S. 430 over that of H.R. 4800.

The Section also urges caution in the use of the language found in H.R. 4800 which prohibits payments for the purpose of procuring "legislative, judicial, regulatory, or other action in seeking more favorable treatment by a foreign government." The Section believes that the statute should make clear that this prohibition does not include lobbying activities that are considered lawful under the host country's legal system, and recommends further study of this issue before any action is taken.

We will be pleased to discuss this subject further at any time. Please contact Allen Green at Suite 800, 1575 Eye Street, N.W., Washington, D.C. 20005, telephone number (202) 789-7523, if

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the Committee has any questions or the Committee requires any further information.

Respectfully Submitted,

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Senator HEINZ. Mr. Green. Thank you.
Mr. Mathews.

STATEMENT OF ARTHUR F. MATHEWS, PARTNER, WILMER, CUTLER & PICKERING, WASHINGTON, DC

Mr. MATHEWS. Mr. Chairman, Senator Proxmire, if I may, I will submit my statement and just make a few remarks in response to some of the issues that have been raised by prior witnesses and with regard to one aspect that I think has not been dwelled upon so far today.

Senator HEINZ. Without objection, so ordered.

Mr. MATHEWS. I speak as a defense attorney, primarily representing corporate and other clients in SEC enforcement actions and Department of Justice criminal prosecutions.

I have never had anything to do with the enforcement of this statute on the Government side. My Government career was long before the statute was enacted. From the defense attorney's side, I might say, there is very little activity or very little concern with this statute among at least the clients and the segments of the business world that I deal with. There was a great deal of concern in the first few years after it became effective, but it is very seldom that lawyers get calls today asking their advice on the ambiguity of the foreign bribery provisions or the other provisions.

FORMAL STATEMENT OF POLICY

I think one of the reasons is that when the statute was first passed, there was some loose language, some interpretations by various persons within and without the Government that seem to imply that businesses could be prosecuted for negligence with re-

spect to matters that were not material, but on the books and records and internal accounting controls provisions side, so-called section 13(b)(2), the SEC quickly reacted to that. Then-Chairman Harold Williams gave an interpretative speech, in essence, giving a great deal of comfort to corporate America, that the SEC would be reasonable in its application of the internal accounting controls and books and records provisions.

The Commission, thereafter, adopted that speech as a formal statement of policy that is still in effect today at the Commission.

Now I understand that one of the purposes of the changes in the present bill on the books and records and internal accounting controls provision is to codify that statement of policy to make sure that it is the law and that it will be the law and will not change as various SEC Commissioners and various SEC Commissions change.

I have no problem with that. I think that will alleviate a lot of concerns.

My problems with the committee's method of going that far is primarily with the articulation. I'm afraid that by eliminating the substantive provision that requires that corporations make and keep accurate books and records as a flat requirement, as opposed to just incorporating it into the internal accounting controls provision, will open up a loophole that will cause tremendous problems, because, as I read the present language, the management—the issuer would only have the obligation to keep accurate books and records with respect to the four subsections of section 4(a)(2), (A), (B), (C), and (D). And as I read those subsections, that would just apply to having accurate books and records, to the extent that are necessary for the auditor to certify the financial statements.

And that would imply that if transactions do not raise to the level of financial materiality, that it would be acceptable to have false books and records. I think that would be a great step backward, if that interpretation is correct.

BOOKS AND RECORDS PROVISION

From my experience, the books and records provision has had a more significant effect on corporate accountability than any statutory provision that I have seen in my 25 years or so of practice of law, both in the Government and outside the Government. The fact that corporate managers can tell their employees, you must keep accurate books and records or the company could be prosecuted, or you could go to jail if you don't, has had a significant effect. It has helped outside directors. It has helped boards of directors. It has helped audit committees assure that subordinates in corporations do things properly.

So I would encourage on that side, in the Senate's attempt to codify what is, in essence, the SEC statement of policy, that I think is a fine statement of policy, that more attention be paid to make sure, for example, that the president of a company could not order the treasurer to:

> Cut a $25,000 check, put it for consulting services, and I am going to use it to pass to a third party to bring a city manager to get a sewer contract or to get a garbage contract.

That $25,000 does not rise to the level of materiality, the fact that there is a false book entry, as I see it, would not be covered by the proposed revision, because if an accountant knew about it, an auditor knew about it, it wouldn't rise to the level of financial statement materiality. So I think that's a defect.

I think when you consider these revisions—I don't know a darn thing about exports or what does or doesn't increase or decrease exports, but the most important part of this statute has not been anything to do with the foreign payments provisions and foreign bribery. It has been with what it has done to corporate America and the internal accounting controls and books and records side.

The SEC—regardless of what administration has been in power and regardless of who has been the Chairman, who has been on the Commission or who has been the head of the Enforcement Division—the SEC has consistently used this statute to develop cases involving domestic bribery, illegal commercial payments, kickbacks, bribery and the like, to attack improper corporate perquisites and to attack wholly domestic cookbooks cases.

I think the Senate should consider very, very carefully whether or not it wants to do anything in this statute that would take away from that effort, because I think it's been a very healthy effort.

For that reason, I also think that once the Senate decides whatever substantive provision it wants to regulate the accuracy of books and records, there ought to be criminal liability for someone who willfully and knowingly, intentionally falsifies corporate books and records. I can't think of any public policy reason why you should give immunity to any low-level or high-level corporate employee, agent, or officer who willfully and knowingly falsifies the books to deceive the Government or to deceive anybody else.

Let me switch to the foreign payments problem. I agree—I haven't had a chance to study Jack Keeney's statement. I've known Jack Keeney for 25 years. I worked with him when I was in the Government. I think virtually every suggestion he makes in his statement constitutes excellent fine-tuning on the bribery provision side that the Senate would do well to consider incorporating in the bill.

With regard to the "reason to know," it's legally not a problem, in the sense that anyone has ever been prosecuted on a "reason to know" standard. If it is having an effect on businessmen and making them too cautious and losing business, because they don't know what "reason to know" means or what a court would say it means. I think the simplest way to solve that is just use the word "knowingly" or "knowing." If the issuer makes a payment to a third party, and I would include agents, as Jack Keeney recommends, knowing that that agent or third party will bribe somebody or make an illegal transfer of that payment, that that should be the violation.

The use of the word "knowingly," and I've cited a bunch of cases in the footnotes to my testimony, traditional, longstanding Federal criminal law, under the mail fraud statute, the wire fraud statute, and the securities fraud statutes, have consistently held that the word "knowingly" in a criminal statute means willful blindness, conscious avoidance or, to some extent, reckless disregard.

As long as that is stated in the Senate report or if the Senate wanted to, in a definition, the word "knowingly" would do the job.

I don't approve of the language "by course of conduct," because it's a strange concept. It's a concept I'm unfamiliar with. I haven't seen it in the law and other areas. It's a concept that I don't think judges are familiar with, and I think it's just as easy to use the word "knowingly," which is a concept that judges easily could explain to layman jurors.

So I would suggest that.

On the grease payment or facilitating payments exceptions, I agree with virtually everything Jack Keeney said. I realize it's a difficult area. I think each of the subsections needs some adjectives, or adverbs, or modifiers.

For example, on a payment, a token of esteem, the Department of Justice recommends using the word "nominal." That would do the job for me, I think. I think it's clear that you can't have a provision where the American company can pay the foreign official it's dealing with a Mercedes car, maybe a Rolex watch, and maybe a $50,000 diamond and ruby necklace for the wife or spouse. For that reason, I think there's a need for some modifier along the lines of the word "nominal."

Similarly, I think some of those four provisions need the concept of good faith or bona fide payments to establish that if it is apparent that the purpose of the payment is to get the contract, as opposed to just being a normal routine facilitating payment, it would be prescribed.

I would be glad to respond to any questions.

[The complete prepared statement follows:]

Testimony of Arthur F. Mathews */
Before The Subcommittee on International
Finance and Monetary Policy and The
Subcommittee on Securities of The Senate
Committee on Banking, Housing, and Urban Affairs,
on S. 430: Proposed Amendments to The Foreign
Corrupt Practices Act (June 10, 1986)

The comments I have regarding proposed amendments to the Foreign Corrupt Practices Act ("FCPA") as contained in proposed S. 430 result from my experience, first, as a government prosecutor and enforcement official in the decade of the 1960's where, among other duties, I spent some time directing the SEC's nationwide criminal enforcement program, and, second, as a defense attorney at Wilmer, Cutler & Pickering for the past 16 years representing individuals and corporations primarily in litigation and governmental investigations involving SEC enforcement and related corporate and white collar crime problems.[1/] I have had extensive experience in my practice dealing with both the internal accounting controls and books and records provisions of the FCPA as well as the corrupt foreign payments provisions of the statute.[2/]

I served on the defense side of many of the foreign payments cases developed by the SEC in the 1970's that led to the passage of the statute. I or my partners represented several of the major multi-national corporations that negotiated SEC consent injunctive decrees involving "questionable" foreign payments. Many of these settlements involved the conduct of Special

Corporate Investigations designed to implement new corporate procedures to assure compliance with federal securities laws generally, and with the FCPA specifically after its passage.[3/]

In addition I have represented many companies and individuals in both SEC investigations and civil injunctive actions, and federal grand jury proceedings and Department of Justice criminal prosecutions under the existing FCPA since its passage in 1977.[4/] Indeed, I have the dubious distinction of being co-counsel in pleading guilty the first individual ever criminally convicted of violating the corrupt foreign payments provisions of the FCPA.[5/]

At the outset in commenting upon proposed S. 430, I would counsel the committees to continue a very careful analysis of the underlying policy considerations before tinkering with a statute as effective as the FCPA has been. Based upon my experience in a large law firm with a national and international practice, I have seen little direct evidence that the anti-bribery provisions of the statute are driving away significant international business from American companies.[6/] On the other hand, I have personally seen significant direct evidence of the value of the books and records and internal accounting controls provisions of the statute in serving the public interest. The FCPA as presently constituted has enabled boards of directors and management officials of both domestic and multi-national companies to

ensure that corporate subordinates safeguard corporate assets and properly adhere to established corporate policies and procedures. Any significant dilution or narrowing of the statute's scope is bound to make it more difficult for directors and managers to audit and control the conduct of corporate subordinates.

Let me deal first with the internal accounting controls and books and records provisions of Section 13(b)(2) of the Securities Exchange Act of 1934, and the proposed changes thereto. Since passage of the FCPA, the SEC has utilized Section 13(b)(2) as one of its most important civil and administrative enforcement tools in its flexible enforcement arsenal. This provision has not been important in foreign payments cases. However, this provision has been the principal underpinning of a potpourri of SEC enforcement actions involving "cooked books" and improper domestic payments regarding wholly domestic business activities of a host of industrial and financial issuers. Although these cases, in the main, involve domestic, not foreign, business activities, this FCPA provision nevertheless has served a significant role in the SEC's unusually effective enforcement program.[1/] The proposed amendments in S. 430, by significantly narrowing the scope of Section 13(b)(2), will needlessly curtail the SEC's effectiveness in so-called "cooked books" cases.

Proposed Section 4(a) would limit the books and records provisions by requiring accurate books and records solely "for

the purposes of subparagraphs (A) through (D). . . ." It appears to me that this limitation would allow corporate officers or employees to falsify books and records, thereby concealing the true nature and purpose of corporate transactions, so long as the result of such falsification is not material to the company's financial statements nor contrary to management's general or specific authorization. If this is so, then management apparently could authorize a bribe domestically to a government official to obtain a government contract, and so long as the amount of the bribe were not financially material, the corporate books and records could falsely cover up the bribe payment without triggering a Section 13(b)(2) violation. This would not serve the public interest.

I realize the books and records provision was criticized in the late 1970's because it contained neither a "materiality" nor a "scienter" requirement. However, the SEC Statement of Policy on the FCPA quickly resolved those concerns.[2/] No one has complained that the SEC has pursued civil injunctive actions in Section 13(b)(2) cases where scienter could not be proven, or where the allegedly false or inaccurate books and records were not falsified in more than an insignificant manner. If the concern is that the SEC Statement of Policy is not law, then Congress could codify its substance. The proposed revisions in S. 430 either go far beyond such codification, or do not sufficiently articulate the desired standard. For example,

SEC Chairman Shad has noted the desirability "to hold management responsible for providing reasonable assurances that corporate transactions are recorded accurately and in reasonable detail."[9/] That specific language, including the term "accurately" should apply to all corporate transactions. In addition, the statute should proscribe any person from knowingly falsifying in any significant manner any corporate book or record, thereby circumventing or undermining management's efforts to assure compliance with the books and records provision.

To the extent that there is any obligation under the statute, as amended, to make and keep accurate books and records, it makes no sense not to provide a criminal penalty for knowing violations of the statute. Why should there ever be wholesale immunity from criminal prosecution for one who knowingly and willfully decides to falsify corporate books and records? The argument that the threat of criminal prosecution for an ambiguous provision restrains and retards legitimate business, is answered by clarifying the ambiguities, and by requiring willfulness and knowledge to trigger criminal exposure. Even under present Section 13(b)(2), while over 100 civil cases have been brought by the SEC, there has been but one criminal prosecution. And that single criminal case was so egregious, it was not even necessary to utilize Section 13(b)(2) -- there were ample other federal criminal provisions available to serve as the underpinning of the criminal case.[10/]

I have no problem with granting the issuer a due diligence defense to civil liability under Section 13(b)(2). That defense probably already exists under present law, and to expressly so provide does not, in my view, detract from the statute's effectiveness.

With regard to the corrupt foreign payments provision of Section 104, I have no problem taking civil jurisdiction away from the SEC and placing all civil and criminal jurisdiction with the Department of Justice. I do not think such a change will impede at all the effectiveness of the SEC enforcement program.

However, I believe there are two major defects in S. 430's treatment of corrupt foreign payments. First, the bill's proposed solution for the allegedly ambiguous "reason to know" concept with regard to payments by third party agents is, in my view, more ambiguous than the present law. I have difficulty with the proposed concept in Section 104(b) providing for liability for a domestic concern or its officers, directors and shareholders only if they "corruptly . . . direct or authorize, expressly or by a course of conduct" a bribe by a third party. I don't know what "a course of conduct" does or doesn't cover. I am unaware of use by the federal courts of such a standard in comparable federal civil or criminal cases. I don't know if judges will know what it means, and I don't know if judges will be able to charge a jury sufficiently so that a jury will

understand what it means. I think the statute would be much more understandable if it used the traditional concept of "knowing" direction or authorization.

Federal courts have historically, in construing the federal mail, wire and securities fraud statutes in the criminal context, construed the phrase "willfully and knowingly" to embrace the concepts of "willful blindness" or "conscious avoidance."[11/] I believe these familiar concepts should apply to corporate liability for bribes made by third party agents. They are concepts that both federal courts and the Department of Justice are familiar with, and are concepts that a jury of ordinary citizens can understand. Whatever particular language is finally chosen, to me it will be important that one will not be able to close his eyes to what any sixth grader would see and understand is going to be a bribe, and avoid criminal liability therefor on a plea of ignorance.

I also feel the "grease" payment exceptions contained in S. 430 are too broad. Section 104(c)(1) authorizes "facilitating or expediting payments" but contains no limitation whatsoever on the size of the payment. I would incorporate some standard of good faith or bona fides in this provision to assure that any payment is solely to obtain performance of a routine ministerial governmental action and not de facto for the purpose of influencing an official in awarding the contract to the payor.

Section 104(c)(2) probably should be limited to the published or written law or regulations of the foreign country.

Section 104(c)(3) contains no limitation whatsoever on the size of the payment. Since an unusually large payment might be viewed as a "courtesy" or a "token of regard or esteem," it would be appropriate to add the limitation "nominal," or some comparable limiting language, in order to prevent the subsection from being a loophole used to disguise major bribes. Similarly, it would be appropriate to add comparable limiting language to subsections (c)(4) and (c)(5).

I believe the FCPA since its passage in 1977 has had a tremendously positive effect on Corporate America. In my 24 years of practice, I cannot think of any statute that has had a more significant effect in raising the level of corporate accountability in this Country. This statute has caused Corporate America to engage in healthy self-analysis and self-investigation, and has substantially upgraded the standards of corporate conduct of both public and private companies. Both aspects of the statute, the anti-bribery provisions and the books and records and internal accounting controls provisions, have served the public interest very well. As presently drafted, S. 430 in my view is not as preferable as the existing statute. At a minimum, the changes I have outlined above should be given further consideration.

FOOTNOTES

*/ Mr. Mathews is a partner in Wilmer, Cutler & Pickering, Washington, D.C. He is an Adjunct Professor at Georgetown Law Center. During the late 1960's he was Deputy Associate Director (Enforcement), U.S. Securities and Exchange Commission.

1/ See, e.g., Mathews, "Effective Defense of SEC Investigations: Laying The Foundation For Successful Disposition Of Subsequent Civil, Administrative And Criminal Proceedings, 24 Emory L.J. 567 (1975); Mathews, "Witnesses In SEC Investigations: A Primer For Witnesses And Their Counsel On The Scope Of The SEC's Investigatory Powers," 3 Rev. Sec. Reg. No. 9, pp. 949-52 (1970); Mathews, "S.E.C. Civil Injunctive Actions -- I and II," 5 Rev. Sec. Reg. Nos. 4 and 5, pp. 955, et seq. (1973); Mathews, Negotiating SEC Consent Decrees: Targets and Tactics for Settling Civil Injunctive Actions (Law & Business, Inc. 1979); Mathews, "The SEC And Civil Injunctions: It's Time To Give The Commission An Administrative Cease And Desist Remedy," 6 Sec. Reg. L.J. 345 (1979); Mathews, "Litigation And Settlement Of SEC Administrative Enforcement Proceedings," 29 Cath. U. L. Rev. 215 (1980); Mathews, "Criminal Prosecutions Under The Federal Securities Laws And Related Statutes: The Nature And Development Of SEC Criminal Cases," 39 Geo. Wash. L. Rev. 901 (1971); Mathews, "Defense of Federal Securities Laws Criminal Prosecutions," Naftalis, White Collar Crimes 105 (A.L.I. 1980)[chapter 3].

2/ See, e.g., Levenson, Mathews and Pitt, The Foreign Corrupt Practices Act of 1977, Do You know This Act Governs Domestic Business Activities? (Law Journal Seminars -- Press 1978); Levenson, Mathews and Pitt, Foreign Corrupt Practices And Internal Accounting Controls (Law Journal Seminars -- Press 1980); Mathews, "The Functioning of Directors in 'Sensitive Payment Inquiries'," Ninth Annual Institute on Securities Regulation at 83-95, chapter 6 (P.L.I., Hardcover, 1978); Outline by Mathews, Klein, Williams and Taylor on "The Functioning of Directors in 'Sensitive Payments' Inquiries," 1 [paperback] Ninth Annual Institute on Securities Regulation at 135-260 (P.L.I. 1977); Mathews and Best, Outline on "Counselling Corporate Compliance With The Foreign Corrupt Practices Act," The Enforcement of The Foreign Corrupt Practices Act by The Reagan Administration at 295-357 (A.B.A., Shine ed. 1983).

3/ See generally, Mathews, "Internal Corporate Investigations," 45 Ohio St. L. Rev. 655 (1984); Mathews, "Defensive Corporate Tactics for Dealing With SEC Investigations: The Role of Outside Counsel," 61 N.C. L. Rev. 483 (1983).

4/ See generally, Mathews, 1 and 2 SEC Enforcement And White Collar Crimes (Law Journal Seminars -- Press 1979); Mathews, SEC Enforcement And White Collar Crimes - 1981 (Law Journal Seminars -- Press 1981).

5/ See, e.g., United States v. C.E. Miller Corporation and Charles E. Miller, Cr. No. 82-788 (C.D. Cal. 1982)[one-count information charging Charles Miller and C.E. Miller Corporation with aiding and abetting criminal violation of FCPA by Crawford Enterprises, Inc., in the "Pemex" case involving paying of bribes to high government officials of Pemex, the national oil company wholly owned by the Mexican government; Mr. Miller pled guilty pursuant to a plea agreement and was placed on probation].

6/ The "Examples of Lost Trade And Increased Costs Created by The FCPA" provided by Ambassador Brock and contained at pages 7-10 of the Report of The Committee on Banking, Housing, and Urban Affairs, United States Senate, to accompany S. 414, Sen. Rep. No. 98-207, 98th Cong., 1st Sess., do not in my view support the significant weakening of the FCPA as presently proposed in S. 430.

7/ See, e.g., Treadway, Speech, "Cooked Books," Institute For Corporate Counsel (Los Angeles, Cal., March 11, 1983), reprinted as Treadway, "Cooked Books: No New Recipes," 30 Fed. Bar News & Journal 323 (June 1983); Treadway, Speech, "The Commission's Enforcement Program And The Integrity of Financial Statements," Sixteenth Annual Securities Regulatory Seminar (Los Angeles, Cal., Nov. 3, 1983); Treadway, Speech, "Accounting Shenanigans And The Commission's 1984 Response," Financial Executives Institute (Chicago, Ill., Feb. 16, 1984); Treadway, Speech, "The Commission, Accounting And (?) Activism," SEC Financial Reporting Institute, University of Southern California (Los Angeles, Cal., May 11, 1984); Treadway, Speech, "The Accounting Function . . . Under The Spotlight And Under Pressure," Seventeenth Annual Rocky Mountain State-Federal-Provincial Securities Conference (Denver, Colo., Oct. 19, 1984); Fedders and Perry, "Policing Financial Disclosure Fraud: The SEC's Top Priority," Journal of Accountancy at 58 (July 1984); Levine, Wade, Bragg and Ferrigno, Outline on "An Assessment of The SEC Response to Financial Frauds, Inaccurate Books And Records And Related Party Transactions," Materials, ALI-ABA 1984 Postgraduate Course in Federal Securities Laws (Stanford Law School, Palo Alto, Cal., July 16-20, 1984); Levine, McLucas and Glanzer, Outline on "Disclosure Obligations of Banks And Bank Holding Companies Under The Securities Laws," Fifth Annual Securities Activities of Banks at 1 (Law & Business, Inc. 1985); Mathews and Levenson, Outline on "SEC Enforcement Regarding Financial Reporting And Certain Counseling Considerations," Materials, ALI-ABA 1985 Postgraduate Course in Federal Securities Law (University of Wisconsin Law School, Madison, Wisconsin, June 16-21,

1985); McLucas and Moore, Outline on "Update -- Recent SEC Enforcement Activities Involving The Foreign Corrupt Practices Act And 'Cooked Books'," Eastern Regional Conference, Institute of Internal Auditors (Teaneck, New Jersey, April 21-24, 1985).

8/ See Harold Williams (then SEC Chairman), Speech, "The Accounting Provisions of The Foreign Corrupt Practices Act: An Analysis," CCH Fed. Sec. L. Rep. ¶ 82,811 (1981). This speech was subsequently adopted as a formal SEC Statement of Policy on the FCPA; see SEC 1934 Act Rel. No. 17,500 (1981), 21 SEC Docket No. 18, at 1466 (Feb. 10, 1981).

9/ See Joint Hearing on Business Accounting And Foreign Trade Simplification Act, S. 414, Senate Hearing 98-33 (Feb. 24, 1983), at p. 51.

10/ See United States v. Joseph H. Hale, Cr. No. 84-253-A (N.D. Ga. 1985), SEC Litigation Release No. 10,668, 32 SEC Docket No. 9, at 627; see also SEC Litigation Releases Nos. 10,536 (1984), 9443 (1981), 9955 (1983), 10,617 (1984), and 10,635 (1984)[Among other 1934 Act criminal charges Hale's conviction for violations of Section 13(b)(2) and Rule 13b2-1 thereunder, the books and records and internal accounting controls provisions of the FCPA, was the first criminal conviction under those provisions.]. See also SEC v. World-Wide Coin Investments, Ltd., 567 F. Supp. 724 (N.D. Ga. 1983).

11/ See, e.g., United States v. Hanlon, 548 F.2d 1096 (2d Cir. 1977)("conscious avoidance); United States v. Sarantos, 455 F.2d 877 (2d Cir. 1972)("conscious purpose to avoid learning the truth" or "willful blindness"); United States v. Jacobs, 475 F.2d 270 (2d Cir. 1973)("conscious purpose to avoid learning the truth"); United States v. Eisenberg, 596 F.2d 522 (2d Cir. 1979) ("conscious avoidance"); United States v. Gentile, 530 F.2d 461 (2d Cir. 1976)("deliberate disregard"); United States v. Brien, 617 F.2d 299 (1st Cir. 1980)("conscious avoidance"); United States v. Squires, 440 F.2d 859 (2d Cir. 1971)(conviction overturned because trial court failed to charge jury on "conscious avoidance"); United States v. Jewell, 532 F.2d 697 (9th Cir. 1976)("willful blindness"); see also G. Williams, Criminal Law: The General Part, § 57 at 157-159 (2d ed. 1961)("To the requirement of actual knowledge there is one strictly limited exception . . . . [T]he rule is that if a party has his suspicion aroused but then deliberately omits to make further inquiries, because he wishes to remain in ignorance, he is deemed to have knowledge . . . . The rule that willful blindness is equivalent to knowledge is essential, and is found throughout the criminal law."); R. Perkins, Criminal Law 776 (2d ed. 1969)("knowledge" includes circumstances where one "deliberately 'shut his eyes' to avoid knowing"); Edwards, The Criminal Degrees of Knowledge, 17 Modern L. Rev. 294, 298, 302 (1954)("willful shutting of eyes,"

"willful blindness," "purposely abstaining from ascertaining," and "willfully abstaining from knowing"). The Model Penal Code provides for criminal liability for corporations for

> "(3) offenses the commission of which is authorized, requested, commanded, performed or recklessly tolerated by the board of directors or by a high managerial agent acting in behalf of the corporation within the scope of his employment." [Emphasis added.]

Model Penal Code § 2.07(1)(c)(3) (P.O.D. 1972). Several state criminal codes contain comparable provisions. See, e.g., N.Y. Rev. Pen. Law §§ 20.20, 20.25 (McKinney 1967); Ill. Rev. Stat. §§ 5-4, 5-5 (1961).

Senator HEINZ. Thank you very much, Mr. Mathews.

Mr. Cohen, Mr. Mathews, at the outset of his testimony, said that he works with business firms that export and that they have expressed no concern to him about the Foreign Corrupt Practices Act. You differ with that; 2 billion dollars' worth.

What's the reason for your difference?

CEO'S CONCERN WITH THE FCPA

Mr. COHEN. I can only note for you, Senator, that at ECAT meetings with chief executive officers on trade issues, the chief executive officers, on their own, bring up the issue of the Foreign Corrupt Practices Act. Most recently, it was a subject that was broached by the chief executive officers at an ECAT annual meeting. I was asked to give a report on the status of the work on the FCPA by the Congress. I proceeded to do so, describing the bills that had been introduced. The CED's feel that the FCPA is an impediment for the very reasons that have been discussed earlier. In particular, they are unable to get a clear reading from internal counsel or outside counsel as to whether a specific transaction would or would not be prohibited by the FCPA. They do not want to go to jail, and some of them do withdraw from pursuing export opportunities. They want the FCPA clarified.

Perhaps too, there is a difference in our views because Mr. Mathews is speaking with different people than those I speak with in business firms.

Among those I speak with are financial officers in corporations. They would point to the accounting provisions as effecting a problem equal to the payments provisions. As a matter of fact, one of them as an ECAT witness before your committee in 1981 referenced the problem with the accounting provisions, as I point out in my written testimony, which perhaps could be inserted in the record. He said as regards accurate records, "I can assure you, there is no such animal that exists on the face of the Earth. It is impossible to have literally accurate and precise records."

What he was trying to suggest is that there had to be some tests with regard to accurate books and records. I think those tests appropriately are put into S. 430. They are a prudent man test and cost-benefit test. Most importantly, S. 430 ties books and records to the internal accounting control provisions of current law.

Senator HEINZ. Mr. Mathews, do you deal with the CEO's and financial officers that apparently Mr. Cohen does?

Mr. MATHEWS. Well, there may be a logical explanation, Senator. I am primarily an enforcement litigation attorney and my dealings with corporate America, in the main, are when someone has questioned what they're doing, either informally or formally. An informal SEC inquiry, a formal SEC investigation, a Department of Justice inquiry. And there has been very little activity with respect to——

Senator HEINZ. So what you're saying is, no one has been getting in much trouble, and therefore, they don't come to you. So it's possible for both of you to be right.

Mr. MATHEWS. It's possible, to a large degree for both of us to be right, of course.

Senator HEINZ. It doesn't mean—the fact that no one's gotten indicted—doesn't mean that people are not erring on the side of supercaution. Mr. Cohen's figures on lost business could be correct. I'm going to ask him about that in a minute. And you could be equally correct.

Mr. Green, you had a comment on that?

Mr. GREEN. Yes, Mr. Chairman. In fact, I just wanted to respond to that question and to that point. In my own practice, I regularly counsel exporters: large companies, small companies, medium-sized companies. The FCPA consistently remains an issue. Advice as to whether a person or a company could be construed to have "reason to know" that an agent is going to engage jiggery-pokery with a Commission is a constant problem, and the question of expenses of procuring officials to visit the tank plant and all of those sorts of things constantly cause problems, in terms of deciding how to comply with the act. And I've seen business lost as a result of it.

POSSIBLE LOOPHOLE

Senator HEINZ. Now Mr. Green, let me ask you, Mr. Mathews says that the changes provided in the accounting procedures, and more specifically removing the criminal liability and attaching only civil liability to any inaccurate or false books and records might—and I think I quote him correctly—might open up a loophole.

Do you agree with that?

Mr. GREEN. I have not focused and the section has not focused on that aspect of potential reform of the accounting standards section with regard to whether it would open a loophole as such. I do not believe, however, that if you criminalize the accounting standards section, that you necessarily should be opening a loophole. The provision is there to require companies to properly account for their assets and not to be able to maintain the sort of slush funds that we saw in the early 1970's. You have a twofold problem, I believe, with the accounting standards section now.

One, there is no materiality threshold. There is no cost-benefit analysis as to how extensive these requirements should be which impacts the smaller- and medium-sized companies, which can and are becoming good exporters now, much more than the larger companies.

And two, at the same time, you criminalize it.

Certainly, absolutely, if we are going to consider maintaining a criminal standard for the accounting standards section, I believe we have to—the Senate certainly should look at—tightening up that standard, looking at a materiality threshold, and permitting some cost-benefit analysis.

I do not necessarily believe that, removing the criminalization would harm it, but I'd have to think further about that.

Mr. COHEN. May I——

Senator HEINZ. Do you want to comment on that, Mr. Cohen?

Mr. COHEN. I think that in S. 430 there is a return to the original intent of the Congress in 1977. The concern would be with the objectives set out in the internal accounting controls system. You would still have a requirement, as I read S. 430, on maintaining

accurate books and records, in order to achieve the stautorily specified objectives of an internal accounting control system.

If that, as I understand it, was the intent originally, I think it is adequately—more than adequately—handled by S. 430.

Senator HEINZ. Let me ask—ask Mr. Mathews, why isn't he correct?

Mr. MATHEWS. I think——

Senator HEINZ. "He," being Mr. Cohen.

Mr. MATHEWS. Yes. The reason why I'm not sure he's correct is, when I read the language, it appears to me that the internal accounting control standards are principally standards to assure that the published financial statements are not materially misleading, and I don't think the language, as drafted, would make it illegal for management, specifically, authorizing direct a bookkeeper or a treasurer to make a false entry that would be, let's say, a commercial problem—$10,000, $20,000, $30,000. And I would be satisfied with the approach that the bill is taking, as long as there was a language change to make it clear that the issuer has a duty——

Senator HEINZ. That it was illegal for somebody to tell somebody else, do it wrong?

Mr. MATHEWS. Well, to make it clear that there was a legal obligation to maintain correct books and records.

Senator HEINZ. There is, under S. 430, a legal obligation. It's not subject to criminal penalties. It's subject to civil penalties, but there is a legal obligation.

Mr. MATHEWS. I have a question whether there is, under this language. That's my problem. Put aside whether or not you criminalize a violation. Let's just stick with the substantive rulings. The way I read the present provision, it would not catch a president directing a bookkeeper to make a false entry on a bribe that was not of a material nature.

Senator HEINZ. I understand your concern.

Mr. Cohen, do you agree with him?

Mr. COHEN. I would think there would be situations in which you would or would not, as he has suggested, catch such a recording error.

Senator HEINZ. Should we change S. 430 to reflect the specific concern that Mr. Mathews has brought up, which I would characterize as saying that we would make it a criminal activity for an officer of a company to direct an employee to falsify books and records.

Mr. COHEN. I think the bill, S. 430 has adequately—in this I differ with Mr. Mathews—has adequately faced this issue.

Senator HEINZ. And you say the issue isn't whether or not that should be illegal.

Mr. COHEN. It's the question of the internal accounting control system, whereby you specify that no person shall knowingly circumvent a system of internal accounting controls established pursuant to the specific objectives of the FCPA. We believe that is going to guide corporate officials on the level of specificity that they need for their books and records, thereby accomplishing the basic objectives of the act. It would satisfy——

OBJECTIVE IS TO PREVENT BRIBERY

Senator HEINZ. Well, the objective of the controls is to prevent bribery.

Mr. COHEN. Yes; and also to make sure that there is an adequate recording of the assets of the corporation and that those assets are correctly disposed.

Senator HEINZ. So let me ask Mr. Mathews, do you disagree with his interpretation of the illegality of knowingly circumventing the section we've just referenced?

Mr. MATHEWS. I think it's very ambiguous. These are accounting terms that the courts have not construed, and as I understand the effort that this committee has put in in drafting this bill is to remove the ambiguity and, therefore, as long as it's conceded that one, under the 11, ought not to be able to direct somebody to falsify the books and records to cover up a bribe or some other legality, it ought to be clear in the language.

Senator HEINZ. Let me turn to the man in the middle, from the American Bar Association.

Mr. Green, who's right? Mr. Mathews or Mr. Cohen?

Mr. GREEN. I can't believe you're asking a lawyer that question, Mr. Chairman. [Laughter.]

Senator HEINZ. It's a dangerous precedent, but ever so often we are in a position where we have to do that.

Mr. GREEN. Well, if I'm going to pick between the two of them, I'm going to pick Mr. Cohen, for this reason. I believe that the accounting standards section requires the further specificity that S. 430 brings it. I believe with regard to whether removing criminalization of the accounting standards section creates a loophole, as I continue to think about it, I really don't think so, for this reason. The accounting standards section is there to require legally the internal controls that a corporation should have in place, and it will be civilly enforced by the SEC, whose job it is to do such things.

The criminalization of the securities laws has always been, I believe, or traditionally been in the area of proffering to the public, through the various public filings of the publicly held company, inaccurate or misleading information. All of that activity will still be criminally enforced. Foreign bribery itself, the act of foreign bribery, which the accounting standards section originally was generated to help prevent, will be criminally enforced.

It seems to me you criminally enforce the acts that you're concerned about with regard to disclosure to shareholders or with regard to foreign bribery, and you don't, therefore, need to criminally enforce the bookkeeping provision itself.

Senator HEINZ. Very well. Senator Proxmire.

Senator PROXMIRE. Thank you very much, Mr. Chairman.

Mr. Mathews, would you agree that S. 430 provides loopholes through which you drive a truck for either foreign bribes or keeping honest records and books?

Mr. MATHEWS. I would on the grease payment or facilitating payment provisions, unless they are at least modified along the lines that the Department of Justice, that Jack Keeney recommended. I think they constitute a major loophole. But I think with some minor modification language that loophole could be closed.

Senator PROXMIRE. How about honest books and records, which you say is far more important? And I think you're right.

Mr. MATHEWS. I think the books and records provision is the most important provision, and I find it ambiguous. I do not understand it. I think it would be very, very difficult for a judge to charge a jury to understand it. I think it ought to plainly state somewhere in (A), (B), (C) and (D)—they talk about transactions executed with management's general or specific authorization and in accordance with management's general or specific authorization. The problem I have is, what happens when management specifically authorizes or directs an illegal payment?

Senator PROXMIRE. So absent a specific amendment of the kind you're suggesting, it could constitute a serious loophole?

Mr. MATHEWS. I think it constitutes a step back from existing law that would be detrimental to the overall public.

Senator PROXMIRE. Now you made a very interesting point, I thought, when you said the only real concern about running afoul of the Foreign Corrupt Practices Act was in the first 2 years it was on the books. Yet in 1978 and 1979, we had a remarkable increase in our exports. We had an 11 percent real annual increase in both those years.

If this was the time when the act was most likely to restrain export activity, it seems to me that there's not much of a case that it's done so.

Mr. MATHEWS. Well, I know nothing about exports, Senator Proxmire, but as I said, I do not oppose deleting the "reason to know" concept, so long as the word "knowingly" is used. I think the law can deal with it fine, as long as it says "knowingly."

Senator PROXMIRE. Mr. Cohen, it seems to me, you've made an excellent case for keeping the "reason to know" standard intact. You said, and I quote:

> Competent foreign sales agents resent the continued surveillance by U.S. companies demanding proof that their sales commissions are not being used to pay bribes.

Of course, they resent it. The act intended that they resent it. So if you take away the "reason to know" standard, you remove a powerful deterrent against bribery, as it seems to me your statement acknowledges.

HONESTY OF AGENTS

Mr. COHEN. Contrary to that interpretation, Senator, I would say that if you are faced with hiring one of two agents—one is an honest agent and one is a dishonest agent—and you put to the dishonest agent the question, "Will you bribe?" The dishonest agent will say, "Of course, I won't bribe, and I'll sign whatever you want me to sign. I won't bribe." The man or the woman who is an honest person might very well be offended by the implication that he might bribe. For that reason, I do not think that under my argumentation you would want to stick with the "reason to know" provision. I could see how——

Senator PROXMIRE. Let me just interrupt to say, I'm surprised. I understand you're a sophisticated, highly competent lawyer, and you know perfectly well, we can't rely on somebody saying, "Are you an honest agent" or "Aren't you an honest agent." Now after

all, you're going to get a response from both agents, "We're honest and we intend not to bribe." They're not going to admit that they're bribing, especially if they have any knowledge of what the law is.

Mr. COHEN. Not being a lawyer, Senator, I would point out——

Senator PROXMIRE. Aren't you a lawyer?

Mr. COHEN. I am not a lawyer, sir.

Senator PROXMIRE. Well, that's one point in your favor. [Laughter.]

Senator HEINZ. Not such a bad fellow, is he?

Senator PROXMIRE. Well, he's improved a lot in the last 10 seconds. [Laughter.]

No, I'm kidding, I think the legal profession is a fine profession.

Mr. COHEN. Based on my experience, I would be much more attentive to the concerns of a foreign national about the United States intruding into areas of custom in his society. If you're talking to an individual who believes that he is performing appropriately in his own society, it is very difficult to sit down with that individual, and try to say, "This is the way things are done in the United States. We will need you to specify that such-and-such is the case." You would hope you could come to an agreement, but for you to get at this whole "reason to know" area, without any gloss from——

Senator PROXMIRE. Well, this is why "reason to know," it seems to me is such a desirable provision in the law, because it doesn't indicate that you simply ask somebody or write them a letter. What it provides is that you make some reasonable inquiries. You either find out if the agent has a reputation as someone who bribes or you don't. That seems to me to put some burden on the corporation to make a reasonable effort to comply with a reasonable standard.

Mr. COHEN. If I could approach the issue differently, I would say that the "reason to know" provision appears to be a provision geared to "after the fact." A businessman is trying to act with foresight. He goes into a situation, as Secretary Baldrige explained, where he might want to export his goods to a foreign country. He doesn't have vast experience about what transpires in the country. He speaks with some agents, or he has his people speak with some agents. He tries to make a decision whether he has before him a sound business deal. He tries to determine that there will not be illegal payments made.

INAPPROPRIATE CONCEPT

When you use a "reason to know" provision, it's "after the fact." Someone might come back to that business executive 2 years after the transaction and say, "You should have had 'reason to know' that a bribe was to be paid." And I think that's another reason why "reason to know" is a particularly inappropriate concept for a business transaction.

Senator PROXMIRE. You've had that in the law now for more than 8 years. As Mr. Mathews says, it seems logical that in the first couple of years, if at all, is when you're going to get a reluctance to participate in export activity. It obviously didn't have

much effect then, because we had a huge increase during that period.

Mr. COHEN. With all due respect, Senator, I think you might have a spurious correlation there. If you're pointing out that passage of the law on the FCPA is occurring at the same time that you have an increase in exports, you have to look at other factors that might explain that increase in efforts.

Senator PROXMIRE. Of course, you do. Of course, you do. But——

Mr. COHEN. And I would suggest that those other factors probably account for the lion's share of the explanation of that increase.

Senator PROXMIRE. Well, that gets me into my next question. Dr. Graham went into this in great detail, as a scholar, and he documented his case that the FCPA did not really inhibit our exports. You say, on page 3 of your testimony, and I quote, "A number of companies estimated that ambiguities of FCPA were a factor in losses of business totaling over $2 billion."

Now as I say, the Graham study found no negative effect in export performance. You picked $2 billion somehow out of the air. I'd be very grateful to you if you could document that in specific detail, not with anecdotes, but with some indication of where you get that very large number.

Mr. COHEN. I'd be pleased, for the record, to submit the membership of the Emergency Committee for American Trade. We did go to our membership. We asked them to respond, as I indicated in my written testimony, which provides a full summary. Some indicated that they did not see increased costs resulting from FCPA. Others saw what they called "loss of business opportunities." It was the ambiguities in the act that they felt accounted, in part, for their loss of business. They could never say in a specific situation that it was the ambiguity that lost them the contract. It was a factor in lost business.

That is one of the reasons why it is a very difficult concept to quantify.

Senator PROXMIRE. Well, you can understand why, as the author of the FCPA, I would be skeptical of that kind of response from those people, even though they're fine people, and I'm sure they're trying to be as honest as they can, but they have a bias.

Mr. Green, on page 27 of your testimony, you refer to the changes that S. 430 would make in the grease payment exceptions already in the FCPA, and note that "such changes would lead to ambiguity as to the purpose and intent of the act itself and the question of its legal enforceability."

And you go on to say, and I quote again, "and places Congress in the position of condemning bribery on the one hand, while listing numerous exceptions to the rule on the other."

So I take it you disagree with Secretary Baldrige, who referred to the changes S. 430 would make in the grease payment exception, and said that these clarifications are the sort of reforms which should help executives understand what their obligations are under the law.

Do you disagree with the Secretary.

Mr. GREEN. No, I don't, Senator Proxmire. I believe that the law requires—simply put—improvement. I believe that the approach

taken in S. 430 certainly is a well-thought-through approach that a lot of people have spent time on to try to remove from coverage of the act, the sort of things that are necessary in foreign commerce that are clearly not intended as a bribe to obtain business.

In part, the need, I believe, for those exemptions arises from the reason to know ambiguity. It also arises from the fact that there is no corollary in the domestic bribery statute to this "reason to know" provision. I do believe that an alternative way, and it could also be a complementary way, to address this problem from the lawyer's point of view, and I believe this would be an approach that would be well understood by the judges, would be to add a specific intent element to one element of the offense, the intent to obtain or retain business. Thus, for example, a potential defendant would have to know that he or she is transferring money to a third party and know that that third party is transferring the money to a foreign public official and intend that that payment is to obtain or retain business.

LISTING EXEMPTIONS

That cuts through, I believe, the whole question of listing exemptions, because that's the bottom line of all of those exemptions that we are listing. And no list is ever going to be perfect and no list is ever going to be agreed to by everyone. So we suggest this as an alternative approach or perhaps complementary one.

Senator PROXMIRE. Now in your testimony, you say at the bottom of page 7,

Nonetheless in the section's opinion, the presence or absence of a competitive effect is not the key issue in considering amendments to FCPA. Indeed, the results of the GAO survey would suggest that FCPA had a corrective effect on U.S. business practices.

Mr. GREEN. Where are you reading from, Senator?

Senator PROXMIRE. The bottom of page 7 and the top of page 8, your last paragraph. "Nonetheless in the section's opinion." Do you have that?

Mr. GREEN. Yes, you may be reading from a slightly earlier draft, Senator.

Senator PROXMIRE. Did you change your mind?

Mr. GREEN. No. No. Not a bit. We are talking about the GAO survey anyway.

Senator PROXMIRE. OK.

The results of the GAO survey would suggest that the FCPA has had a corrective effect on U.S. business practices. Bribery should be condemned as the means of conducting business.

Mr. GREEN. All right.

Senator PROXMIRE. Then you go on to say,

If business is lost, because bribery is curtailed, Congress has deemed that to be an acceptable cost for promoting lawful conduct.

LOSS OF BUSINESS OVERSEAS

Mr. GREEN. Well, I think the point we're making there, Senator, is simply that the GAO survey would shows that of 250 companies randomly selected by GAO to survey with regard to the potential

or actual effect of the FCPA, approximately 75 percent of those 250 companies responded, and that's to the General Accounting Office, as opposed to a private sector survey, and 30 percent said that they had lost overseas business as a result of the FCPA.

So we make that point, and I think you would like to see some actual data supporting this notion of lost business, which is, of course, an extremely appropriate question. It's not really my province as a lawyer to attempt, I think, to support that. I see it in my practice. We do point out the result of the GAO survey, which we think is relevant.

Senator PROXMIRE. I have one last question.

You note on page 12 of your testimony, that the Justice Department presently views the "reason to know" standard—I quote—"as an inappropriate and harsh standard for criminal prosecution."

May I ask you, did the ABA research on this issue reveal whether the Justice Department in previous administrations also opposed the "reason to know" standard? During the Ford administration, and the Carter administration—what was the Justice Department's position in those administrations.

Mr. GREEN. I would not be prepared right now to walk back through every administration's support or lack of support, sir, of the "reason to know" standard. Certainly, we would be happy to develop that data for you.

Senator PROXMIRE. Thank you.

Mr. COHEN. If I could be of help——

Senator PROXMIRE. Mr. Cohen.

Mr. COHEN. With regard to the FCPA, I am aware that during the Carter administration, the "reason to know" provision was identified as one of the major export disincentives facing American business. The report was issued in the last year, as I recall, of the Carter administration. The U.S. Trade Representative, former Governor of Florida, Reubin Askew, spoke out on the need to reform the Foreign Corrupt Practices Act during the Carter administration.

Senator PROXMIRE. Very good. Well, even the Carter administration wasn't perfect. [Laughter.]

Senator HEINZ. No. [Laughter.]

Senator PROXMIRE. I knew we could find something to agree on today.

Senator HEINZ. We could get a unanimous vote on that. [Laughter.]

Well, I don't sense all that much disagreement among the witnesses here at the table. I detect only modest disagreement here in the committee. I am really quite pleased with the unanimity of both the witnesses and the committee on the need for improvements in the Foreign Corrupt Practices Act. You know, it's a very important act. It's a very good act. We want to be clear that bribery is illegal, and you, Senator Proxmire, can claim legitimate credit for having pioneered some very important ground. And I mean it sincerely, that I think the entire country owes you a debt, because the original legislation is milestone legislation.

I really believe that to the extent there are any amendments to it, we are only fine-tuning. We are not rerouting your trailblazing work. The objective is—and I share it with you—to make sure that illegal acts, such as bribery, aren't committed. And I don't think there's a member of this committee who disagrees with that objective, and I think probably if there is any disagreement, we're not disagreeing over no more than 5, 10 percent of the substance. I don't mean the words, the substance of what's before us.

In any event, I am hopeful that we can resolve our differences, to the extent they are substantive and real, and that we can make the necessary changes, because I think even you, Senator Proxmire, might agree there are some things, such as the Eckhardt rule, that need some fine tuning.

Senator PROXMIRE. Mr. Chairman, if you and I could just agree on one single aspect of S. 430, I think it would be fine. That is, if we could both agree to label the bill, "The bring back bribery bill." [Laughter.]

Senator HEINZ. We may have a disagreement on that, Senator Proxmire. I've never known you to be given to hyperbole.

Senator PROXMIRE. Never.

Senator HEINZ. This may be one of those rare instances where I feel you overcharcterize the legislation.

The Chair thanks you for your excellent questions and, with the exception of the new titling of the bill, has found your involvement really quite important and most appreciated.

Senator PROXMIRE. Thank you, Mr. Chairman.

Senator HEINZ. Thank you, all.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

[Response to questions from the committee and additional material for the record follow:]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM MALCOLM BALDRIGE

Q. 1. Does the Administration support removal of agents from section 104(a) of the Foreign Corrupt Practices Act (FCPA)?

A. 1. The provision of the FCPA which has probably led to the greatest amount of uncertainty in the business community is the provision dealing with the responsibility of a corporate officer for the acts of an agent. The FCPA currently imposes criminal liability on a corporation and its officers if they have "reason to know" that a third party, such as an agent, is going to use corporate funds to bribe a foreign official. See 15 U.S.C. §78dd-1(a)(3) and 15 U.S.C. §78dd-2(a)(3). This is one portion of the FCPA which has led U.S. exporters to exercise unnecessary caution in order to make sure that they are not held responsible for the unauthorized acts of agents. The Administration strongly supports the revision of the "reason to know" standard as articulated in S. 430.

It is important to note a distinction between the use of the term "agents" in the Department of Justice testimony and in the Department of Commerce testimony. The Commerce testimony focused on the problems with the standard in current law governing corporate liability for the acts of "agents" as noted above.

The portion of the FCPA regarding "agents" discussed in the Justice testimony does not involve the question of the liability of a corporation for the acts of agents. Rather, the Justice testimony concerned the use of agents in the first sentence of the basic antibribery provision. See 15 U.S.C. §78dd-1(a) and 15 U.S.C. §78dd-2(a). This section provides that:

> "[It] shall be unlawful for any issuer (domestic concern)..., or any officer, director, employee, or agent of such issuer (domestic concern)...to make use of the mails...corruptly to...."

The Justice Department in its testimony recommended that the Congress consider retaining "agents" in this section of the FCPA because its deletion may be construed by a court to mean that the FCPA does not apply to the actions of the agents themselves. As noted in your question, you intend S. 430 to cover the actions of agents. If this intent is to remain clear, however, "agents" should be included in the list of individuals subject to the basic antibribery provision.

The Administration is also aware that the inclusion of "agents" can make it more difficult for U.S. exporters to compete abroad. This problem is particularly severe for U.S. firms who rely on foreign agents to market their products abroad. Because of cultural and other differences, foreign nationals often resent U.S. firms insisting that they sign contracts which require them to comply with U.S. law in representing the firm in their own country. In some cases, these individuals believe that the request that they sign a contract with such a clause implies that the U.S. firm believes they are not trustworthy. As a result, U.S. exporters often find that they are not able to attract the best foreign agents and end up losing these agents to their competitors.

Although this problem is significant, the proposed deletion of "agents" creates problems of its own. As noted by the Justice Department, some foreign governments are more willing to cooperate when we can show them evidence that their own citizens are violating U.S. laws. Removing this impetus for cooperation will, from an enforcement perspective, hamper the prosecution of violations of the FCPA. For this reason, the Administration recommends that you consider retaining "agents" in the list of individuals subject to the basic antibribery provision.

Q. 2. Does the Administration support the provisions of S. 430 which would establish procedures to review business practices and records and to respond to specific inquiries concerning compliance with the FCPA?

A. 2. The Department of Justice testimony accurately reflects the position of the Administration. It notes that the current FCPA Review Procedure makes the new procedures unnecessary. While the requirement that these opinions be issued within 30 days would greatly assist the business executive, it is unrealistic given the complexities of issues involved in international transactions. It would also severely strain the Justice Department's resources at a time of fiscal restraint.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM MALCOLM BALDRIGE

Q. 1. Is there any hard data that American business has lost a significant amount of foreign business as a result of the FCPA?

A. 1. The GAO study on the FCPA in 1981 and the U.S. Chamber of Commerce Report, "The Price of Ambiguity: More than Three Years Under the Foreign Corrupt Practices Act" accurately document the need for clearer guidance under the FCPA. The Chamber of Commerce Report is especially useful in that it provides specific examples of the problems encountered by U.S. exporters as a result of the uncertainty created by the Act.

It is not possible, however, to quantify the amount of exports lost as a result of the statutory ambiguity. One cannot isolate the effect on exports resulting from companies foregoing legitimate export opportunities because of their fear of inadvertent violations of the FCPA from other factors simultaneously affecting exports. There are numerous factors, such as the high value of the dollar in the recent past, which have affected the competitiveness of U.S. products. The imprecise language used in the FCPA is one factor because it requires U.S. executives to use unnecessary caution which puts them at a competitive disadvantage in competing with foreign firms.

Q.2. Has anything changed since 1981 vis-a-vis the ability of U.S. firms to compete in international markets that would obviate the need for S. 430?

A.2. No. As noted above, there are many factors which affect the ability of U.S. firms to compete abroad. In the long run, the fall in the value of the dollar will improve the ability of U.S. firms to compete in international markets. That is one part of the mosaic of competitiveness. The ambiguities of the FCPA, which deter U.S. companies from taking advantage of legitimate export opportunities, is another part. Inasmuch as the FCPA can be clarified to remove those ambiguities without weakening the sanctions against international bribery, it serves as a needless export disincentive.

Q. 3. Is the Administration taking steps to negotiate an international treaty? If so, when can we expect some results? If it is not attempting to do so, why not?

A. 3. The Department of State has worked for several years to negotiate such an agreement in the Economic and Social Council of the United Nations. To date, the United States has been unable to interest other nations in pursuing an agreement (further progress on the draft agreement has been blocked by the G-77). The item remains on the Council's agenda, however, and no new negotiations need to be proposed.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM MALCOLM BALDRIGE

Q. 1. What is the Administration's position on the changes to the FCPA made by the House bill (H.R. 4800)?

A. 1. While the Administration supports a few elements of the House bill which bring needed clarification to the FCPA, we oppose many of the provisions which were added during consideration of the bill. Instead of clarifying the FCPA, many of these provisions would introduce new ambiguities which would create additional uncertainty about what is permitted under the Act. In particular, we oppose the following amendments set out in H.R. 4800:

a. Liability for acts of a third party. The bill introduces a split standard for determining the liability of a corporation and its officers for the acts of agents. Criminal liability is based on a "knowledge" standard, civil liability is based on a "reckless disregard" standard. With respect to the "knowledge" standard, the House bill defines "knowing" to include situations in which a person is "aware of a high probability, which he or she consciously disregards in order to avoid awareness or substantial certainty...." As noted in the testimony of Allen Green on behalf of the Section of Public Contract Law of the American Bar Association, this definition contains an element of "recklessness" which is not appropriate in a criminal statute like the FCPA.

We also oppose the separate civil standard based on "reckless disregard." This standard is basically a negligence standard and would subject U.S. firms to civil penalties for actions abroad which would not be subject to similar penalties under domestic bribery laws.

b. Tenfold increase in criminal fines. The House bill increases the amount of the fine a court can impose on a corporation from $1 million to $2 million, and increases the amount of the fine for individuals from $10,000 to $100,000. We are not aware of any justification for increasing the amount of the fines under the FCPA -- much less increasing them tenfold -- and believe the fines in current law are fully adequate for enforcement purposes. Further, the sanction which deters U.S. executives from violating the Act is the possibility of imprisonment for up to five years, more so than the possibility of being assessed a fine.

c. "Procurement of legislative, judicial, regulatory, or other action." The House bill seeks to "clarify" that the basic prohibition against making corrupt payments to assist the company in obtaining or retaining business includes "the procurement of legislative, judicial, regulatory, or other action in seeking more favorable treatment by a foreign government." This new clause does not clarify the Act, but introduces new, extremely vague terms which are certain to cause greater confusion about what is permitted and what is prohibited under the FCPA.

d. Other provisions. There are numerous other provisions in H.R. 4800 which are counterproductive. These include:

- Defenses - recasting payments which have never been considered to fall within the restrictions of the FCPA as "defenses" which must be proven by the defendant (not the prosecutor);

- Payments for "routine governmental actions" - while the Administration generally supports inserting an explicit provision in the FCPA regarding "facilitating" payments for routine governmental action, the provision in H.R. 4800 is overly restrictive and will be of limited use.

- "Due diligence" defense - establishing a special defense for companies which have set up procedures to prevent and detect violations of the FCPA. This "defense" will lead overly cautious managers to establish special "due diligence" procedures which are duplicative of the internal accounting controls which are already required under the FCPA.

e. The House bill also fails to make several amendments which the Administration supports, such as consolidating at Justice enforcement authority over the antibribery provisions, clarifying the accounting provisions, and specifying that the FCPA is the exclusive means for prosecuting international bribery (provided a technical amendment is made concerning the problem with the "Eckhardt amendment" as discussed in the Justice testimony).

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PROXMIRE--BALDRIGE

Q. 2. Can you give the Committee some concrete examples of actions whose legality would really be unclear under the present law but would be clearly legal under S. 430?

A. 2. Under current law, U.S. firms may not make payments to foreign officials for the purpose of obtaining business. As defined under the FCPA, "foreign official" does not include employees of a foreign government "whose duties are essentially ministerial or clerical." While the legislative history to the FCPA indicates that certain types of "facilitating" payments were not intended to be covered by the prohibition against bribery, the statute itself focuses on the functions of the official. Inasmuch as it is often difficult to determine whether the duties of a foreign official are "essentially clerical or ministerial," U.S. exporters are not certain about the types of payments which are not intended to be subject to the FCPA prohibitions. S. 430 provides better guidance to the exporter by focusing on the purpose of the payment. For example, under current law, a payment to a legislator to advocate the position of a private party would be questionable even if such a payment were permitted under local law (local law may permit a legislator to accept a fee as long as the legislator fully discloses the arrangement.) S. 430 states clearly that the FCPA does not apply to any payment which "is lawful under the law or regulations of the foreign official's country."

Another example would be a payment needed to secure adequate police protection. The legislative history of the FCPA states that such a payment is not intended to be covered by the FCPA. Because the Act itself, however, exempts only payments to foreign officials whose duties are essentially "ministerial or clerical," the permissibility of the payment is questionable. S. 430, by focusing on the purpose of the payment (securing the performance of a routine governmental action), provides much clearer guidance.

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PROXMIRE--BALDRIGE

Q. 3. How can you argue that S. 430's "course of conduct" standard is clearer than the "reason to know" standard in present law?

A. 3. The primary shortcoming of the "reason to know" standard in present law is that it fails to give adequate guidance to U.S. exporters to enable them to know with reasonable certainty what kind of behavior can result in corporate liability for payments made by an agent. This standard, which is basically a negligence standard, imposes criminal liability on the corporation and the officers even for the unauthorized act of an agent if there was "reason to know" of the payment. U.S. exporters are uncertain about what kinds of information may lead a court to determine there was "reason to know." This uncertainty leads to an exercise of unnecessary caution which hurts the ability of U.S. exporters to compete abroad.

The "course of conduct" standard in S. 430 is clearer -- and fairer -- because it imposes the harsh sanctions of the law only against those persons who act to bring about the conduct which the FCPA was meant to proscribe -- bribery to obtain or retain business with foreign governments. It subjects a principal to the criminal sanctions only if the principal directs or authorizes the agent to make a payment either directly, or indirectly by "course of conduct." Under the "reason to know" standard, a U.S. executive can not gauge when he might be held criminally responsible for an unauthorized payment by an agent because a court may determine that some isolated fact or series of facts constituted "reason to know." Under the standard of S. 430, on the other hand, the U.S. executive knows that it is his own behavior which will determine culpability -- that is, do the actions of the executive direct or authorize the agent to make an illicit payment.

While "reason to know" has been used in other statutes, it is not appropriate for purposes of imposing harsh criminal sanctions and is peculiarly inappropriate for use as a standard for governing liability for the actions of agents under a foreign bribery law. The standard of S. 430 is a major improvement in this regard and will generally apply the same sort of standard of liability for foreign bribery as used to determine liability under the domestic bribery statute.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM EDWARD H. FLEISCHMAN

Question #1. Is the SEC's position that liability under the antibribery provisions of FCPA should be imposed upon a defendant if he has "reason to know" that a payment will be used for the purpose of influencing [a] public official or if a defendant has "reason to suspect" the nature of the payment?

Answer to Question #1. Section 30A of the Securities Exchange Act of 1934, setting forth the antibribery provisions that the Commission administers civilly, provides that a defendant may be liable if he makes a payment to an agent "while knowing or having reason to know" that all or a portion of the money or thing of value will be used to influence a foreign official or political party improperly. The term "reason to know" has not been construed by any court in an FCPA case. "Reason to know" has been defined, outside the FCPA, in various ways, however. For example, one court has held that

> [a] person has reason to know if he has information from which a person of ordinary intelligence, or of the superior intelligence which such person may have, would infer that the fact in question exists or that there is such a substantial chance of its existence that, if exercising reasonable care with reference to the matter in question, his action would be predicated upon the assumption of its possible existence.

Von Gohren v. Pacific National Bank, 8 Wash. App. 245, 255, 505 P.2d 467, 472 (1973), citing Restatement (Second) of Agency § 9 comment d (1958). Another court has held that "[s]uspicious

characteristics of the transaction" may give an individual "reason to know." Colin v. Central Penn National Bank, 404 F. Supp. 638, 641 (E.D. Pa. 1975), aff'd, 544 F.2d 512 (3d Cir. 1976). Accordingly, depending on the particular facts of a case and the court's interpretation of the "reason to know" standards, suspicious characteristics of the circumstances could lead to a conclusion that a defendant had "reason to know."

American businessmen have expressed great concerns over the "reason to know" test, stating that it is difficult to interpret and apply. In response to those concerns, S. 430 would eliminate that test. The Departments of Commerce and Justice have expressed support for replacing the "reason to know" standard with a more objective test, to improve the clarity of the antibribery provisions. As we have previously stated, since S. 430 would eliminate the Commission's authority to enforce the antibribery provisions, the Commission defers to those agencies with respect to all of the S. 430 amendments to those provisions.

Question #2. Is the existence of an "agreement" to make a payment sufficient to sustain a violation of the FCPA or must the government demonstrate actual payment and an intent to violate the Act to incur liability under FCPA? If intent and an actual payment need not be demonstrated, then couldn't liability flow from the unauthorized actions of an agent not controlled by a corporate defendant? Therefore, isn't it difficult to predict what actions will constitute violations of the antibribery provisions?

Answer to Question #2. To establish a violation of the antibribery provisions, the government need not demonstrate that an actual payment has been made. Existing law expressly encompasses an "offer, * * * promise to pay, or authorization of * * * payment" along with an actual payment.

However, in the situation you pose, there would be other preconditions to a successful prosecution. For example, the government must show use of an "instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to" a foreign official or political party. The legislative history of the FCPA indicates the word "corruptly" requires that the offer, payment, promise, or gift be intended wrongfully to influence the recipient to misuse his official position. H.R. Rep. No. 640, 95th Cong., 1st Sess. 7-8 (1977); S. Rep. No. 114, 95th Cong., 1st Sess. 10 (1977).

Moreover, in the case of payments to an agent, the issuer and its officers, directors, and employees may be liable if they knew or had "reason to know" that all or a portion of such money or thing of value would be offered, given, or promised to a foreign official or political party. Conversely, an issuer would not be liable for the unauthorized acts of an agent it does not control if it does not know or have "reason to know." As noted in the answer to Question #1 above, however, that standard has

created interpretive difficulties for American businessmen. S. 430 would replace the "reason to know" standard with a more objective test.

Question #3. Some critics of the FCPA contend that the Act's accounting provisions have greatly increased the cost of doing business for issuers. These critics also contend that the cost[s] of complying with the accounting provisions greatly exceed any benefits derived from them. How do you respond to these criticisms?

Answer to Question #3. The Commission believes that accurate corporate recordkeeping and meaningful accounting controls are essential to the operation of any public company. As the Commission has previously stated, these are

> inherent obligations of the stewardship of a public corporation. The standards embodied in the Act's accounting provisions are, in effect, the cardinal principles of managing a business enterprise. Among members of the business community, few would dispute that acceptable management cannot be achieved absent such records and controls.

Securities Exchange Release No. 17500 (Jan. 29, 1981) ("1981 Policy Statement"). Thus, the costs of creating and maintaining effective recordkeeping and control systems are inherent in the operation of any large enterprise and, correspondingly, such systems generate significant corporate benefits.

At the same time, the Commission recognizes that corporations should not be forced to create internal controls that are unnecessarily expensive in light of the particular circumstances. In the 1981 Policy Statement, the

Commission addressed those concerns:

> Thousands of dollars ordinarily should not be spent conserving hundreds. Further, not every procedure which may be individually cost-justifiable need be implemented; the Act allows range of reasonable judgments. * * *
> * * *
>
> * * * [C]onsiderable deference properly should be afforded to the company's reasonable business judgments in this area * * *. Importantly, the selection and implementation of particular control procedures, so long as they are reasonable under the circumstances, remain management prerogatives and responsibilities.

In those statements, the Commission reflected Congress' anticipation that management may "evaluate the cost/benefit relationship of the [internal control] steps to be taken." S. Rep. No. 95-114, 95th Cong. 1st Sess. 8 (1977). The Commission remains of the same view. S. 430 would amend the Act to require a system of controls that would "satisfy prudent individuals in the conduct of their own affairs, having in mind a comparison between benefits to be obtained and costs to be incurred in obtaining such benefits." This test is consistent with Congressional intent, with the 1981 Policy Statement and with auditing standards, which recognize that "the cost of internal control should not exceed the benefits expected to be derived." Statement on Auditing Standards No. 1, Section 320.32.

Question #4. What is the SEC's position regarding the standard needed to determine an accounting violation of the FCPA -- does the mistake have to be material to impose liability under the Act? Must "scienter" be demonstrated to impose liability under the Act's accounting provisions?

Answer to Question #4. The provisions of the FCPA do not require that an inaccuracy be "material" to trigger liability. As the Commission has previously indicated, a traditional materiality test would be inappropriate as a standard for an internal control system, since it is too high a threshold. See 1981 Policy Statement. Rather, the FCPA requires that a public company's records must, "in reasonable detail, accurately and fairly reflect" disbursements of its assets, and its internal accounting controls must be "sufficient to provide reasonable assurances" that the Act's objectives will be satisfied. Section 13(b)(2) of the Securities Exchange Act of 1934 (emphasis added). This standard allows flexibility in responding to particular facts and circumstances.

Scienter need not be demonstrated to establish a violation of the FCPA's accounting provisions. SEC v. World-Wide Coin Investments, Ltd., 567 F. Supp. 724, 749 (N.D. Ga. 1983). As the Commission has previously testified, however, inadvertent record-keeping mistakes will not give rise to Commission enforcement proceedings. Statement of the Honorable John Shad, Chairman, Securities and Exchange Commission, before Joint Hearings of the Subcommittee on Securities and the Subcommittee on International Finance and Monetary Policy of the Senate Committee on Banking, Housing and Urban Affairs concerning S. 708, June 16, 1981 ("1981 Testimony") at 26.

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Question #5. Could the falsification of accounting records by a low level employee without management's knowledge or acquiescence trigger liability under the FCPA?

Answer to Question #5. As the Commission previously has made clear, it is inappropriate to hold a corporation liable for recordkeeping or internal controls violations by low or middle level employees, without any involvement by senior officials. Statement of the Honorable John Shad, Chairman, Securities and Exchange Commission, before Joint Hearings of the Subcommittee on Securities and the Subcommittee on International Finance and Monetary Policy of the Senate Committee on Banking, Housing and Urban Affairs concerning S. 414 (February 24, 1983) at 7; 1981 Testimony at 15-18.

> Rather, the Commission looks to
>
> the adequacy of the internal control system of the issuer, the involvement of top management in the violation, and the corrective actions taken once the violation was uncovered. If a violation was committed by a low level employee, without the knowledge of top management, with an adequate system of internal control, and with appropriate corrective action taken by the issuer, [the Commission does] not believe that any action against the company would be called for.

1981 Policy Statement.

Question #6. Does the SEC seek out violations of the FCPA accounting provisions for their own sake or will it bring enforcement actions only where other violations of the securities laws are involved?

Answer to Question #6. In investigating putative violations of the Act, the Commission's Enforcement Division does not discriminate

among violations to be sought or to be charged. To date, the Commission has brought 73 actions to enforce the accounting provisions of the Act. The violations of the accounting provisions in all of those cases were uncovered in connection with inquiries into other possible violations of the securities laws. In all but three of the Commission's enforcement actions, other violations of the securities laws were charged.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM JOHN C. KEENEY

Question 1. I understand that the Justice Department has established a review procedure (28 C.F.R. sec. 50.18) to give meaning and guidance in clarifying the fine line between corrupt payments versus entertainment and business gifts and bribes versus a payment resulting from an extortion demand by a government official.

a) How does this procedure work?

b) Has it been used very frequently? How many times since the procedure was put in place?

c) Has the private bar found the review procedure to be effective? If so, what can you cite as evidence to support your statement?

Response: The Foreign Corrupt Practices Act (FCPA) Review Procedure became effective on March 20, 1980. Under the Procedure, private parties may submit to the Department in writing the specific details and material information concerning proposed conduct which the party believes may be affected by the FCPA. Upon review of the request, the Department responds by indicating its present enforcement intention with respect to the proposed conduct. The opinion expressed by the Department is applicable to that particular request only and is valid only to the extent that the facts upon which it is based remain unchanged. The Procedure provides for responses to be made within 30 days; however, when necessary, some applications have been expedited and responses have been made in a matter of days. On the other hand, where adequate essential information has not been supplied in the initial submission by the applicant, responses have taken somewhat longer.

The Review Procedure has resulted in 18 Department opinions since its inception. On various other occasions, applications for review have been submitted but subsequently withdrawn. In addition, the Criminal Division of the Department has received frequent telephone inquiries about the Procedure which are not followed by any written request. From discussions with a number of private counsel, we believe that far more frequently it is the private bar which has been consulted and which has given substantive advice to private parties concerning FCPA questions in much the same manner as private advice is given regarding questions of potential violations of the federal securities, tax and other statutes.

We have received no complaints from the private bar concerning the Procedure. Therefore, we are unable to respond to your question concerning whether the private bar finds the Procedure effective.

Question 2. Has there been an increase or decrease in the number of cases brought under the FCPA in the last five years? What are the reasons for this trend?

Response: The number of investigations and prosecutions under the FCPA has remained relatively constant in the last five years. The number of allegations of violations has also remained constant during that time period, although diminished from the preceding five year period. The prosecutive effort with respect to allegations received by the Department has likewise remained at the same level. While we cannot say with certainty, we believe that the decrease in the number of allegations between the first and second five year periods is a result of two factors: the clearing up of the initial backlog of allegations of criminal activity and the deterrent effect of the statute.

Question 3. Would the imposition of civil penalties alone, rather than civil and criminal penalties be sufficient to deter violations of the FCPA?

Response: To replace the criminal sanctions imposed by the current statute with simple civil penalties will, in our opinion, greatly diminish the deterrent effect of the FCPA. If the risk of conduct in violation of the statute becomes merely monetary, the fine will simply become a cost of doing business, payable only upon being caught and in many instances, it will be only a fraction of the profit acquired from the corrupt activity. Absent the threat of incarceration, there may no longer be any compelling need to resist the urge to acquire business in any way possible. Perhaps, even more importantly, reducing the impact of the FCPA to a civil level could send a message both here and abroad that bribery is not as serious an offense as previously thought.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM JOHN C. KEENEY

Question 1. The New York Times recently reported that a federal grand jury in Pittsburgh has begun an investigation into allegations that the Westinghouse Corporation made an $80 million payment to a close friend of President Marcos in order to win a competition with the General Electric Corporation for a $1.1 billion contract to build the first nuclear plant in the Philippines.

Can you tell us whether such an investigation is in progress and if so its current status? If it is not completed will you inform me of its conclusions and any action taken by the Department when it is completed?

Response: The Department of Justice is presently conducting an investigation of allegations that the Westinghouse Corporation made payments to foreign officials in the Philippines in order to obtain a contract to construct a nuclear power plant in that country. The Department has recently entered into a Mutual Assistance Agreement with the Philippine government in an effort to obtain testimony and documents relating to these allegations. No charges have yet been brought, but the Department will endeavor to advise you once the investigation is completed.

Question 2. I understand that the Department of Justice is conducting an investigation into allegations that five major defense contractors, including the General Dynamics Corporation, paid large sums of money to Mr. Eung-Yul Yoon, a retired South Korean air force general for his help in making weapons sales to the Korean government.

Can you tell me the current status of this investigation? If it is not yet completed, will you inform me of its results as soon as it is completed?

Response: The Department of Justice is presently conducting an investigation of allegations that several major defense contractors, including General Dynamics, may have made payments to Korean foreign officials in order to obtain business from the Korean government. No charges have as yet been brought, but the Department will endeavor to advise you when the investigation is completed.

Question 3. On page 3 of your testimony, you state that a more objective standard than "reason to know" could improve the clarity of the Act - but you make no suggestion as to what that standard should be. Can you make a recommendation on that?

Response: As noted by the Administration's witness at the hearing, the Administration supports the more objective and predictable "direct or authorized" standard of S. 430 to current law. In a July 26, 1982 memorandum to the Energy and Commerce Committee of the United States House of Representatives, then Deputy Attorney General Edward C. Schmults endorsed such language as a preferable alternative to "reason to know."

Under a "direct or authorize" type provision, the standard of proof would be similar to that applicable in domestic bribery cases involving an intermediary as payee. This alternative would prevent a company or businessman from using an agent or another third party as a protective shield from criminal prosecution.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM CALMAN J. COHEN

Question No. 1:

Mr. Keeney of the Justice Department argued (see p. 2 of enclosed statement) that section 104(a) of the foreign payments provisions of S.430 should not omit agents from those covered by the Act's anti-bribery provisions. Mr. Keeney contends that retention of agents within the Act's coverage provides an important enforcement tool for those that fall within this group. On the other hand, many small and medium-sized businesses complain that they do not have the time and money needed to assure themselves that an export transaction handled by an agent will not result in criminal liability under the Act.

How important do you view the deletion of agents from the Act's coverage as a signal to businesses that they will not be held vicariously liable for the criminal activity of others?

Answer to Question No. 1:

Agents are not deleted from the Act's coverage, given that business will be held liable if it intends to have an agent make an improper payment. The issue of agents in S.430 is principally covered not in Section 104(a) but in Section 104(b), which establishes criminal liability for a U.S. business which directs or authorizes, expressly or by a course of conduct, that an agent make a payment to a foreign official in order to obtain or retain business.

Virtually every government prohibits the bribery of its officials. The primary responsibility for the prosecution of a foreign agent who bribes a foreign government official should rest not with the U.S. government, but with the foreign government itself.

In addition, those agents who are citizens, nationals, or residents of the United States would be covered under Section 104(a). The definition of "domestic concern" in Section 104(f) covers "any individual who is a citizen, national, or resident of the United States; or (B) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States, which has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, or which is required to file reports under section 15(d) of the Securities Exchange Act of 1934."

Question No. 2:

Mr. Keeney also argued for removal of the provisions in S.430 requiring binding opinions and enforcement guidelines from the Justice Department. Critics of the Act's present review procedure

contend that there is a need for the Attorney General to issue binding advisory opinions in regard to specific inquiries concerning foreign payments.

How important do you view the provisions in S.430 requiring the Justice Department to issue binding advisory opinions concerning foreign payments? (An advisory opinion would be issued with the caveat that it be valid only insofar as it is not at variance with the facts on which the opinion was based.)

Answer to Question No. 2:

Requiring binding opinions and enforcement guidelines from the Justice Department will be of assistance to U.S. business. Specifically, requiring the Justice Department to issue binding advisory opinions concerning foreign payments will strengthen significantly the responsiveness of the current Business Review Procedure.

A precedent for the issuing of binding advisory opinions by the Department of Justice is found in the Export Trading Company Act.

Question No. 3:

In both the FCPA and S.430 there is a provision (the Eckhardt Amendment) prohibiting the conviction of an employee of a domestic concern unless the domestic concern itself is "found to have violated" the Act. The purpose of the provision is to prevent a company from labeling an employee a renegade, thereby using him as a scapegoat for the company's criminal acts. The Justice Department finds this language deficient, because it has been too strictly interpreted by the courts: a company must have been actually convicted to allow an enforcement action against one of its employees; and a company that enters a guilty plea is not "found to have violated" the Act. The Justice Department argues that companies can plead guilty to an FCPA violation without being convicted, and leaving the employee or agent to defend himself. They advocate correcting this problem by adding language requiring a company to indemnify an employee's attorney's fees unless it can prove that the employee was clearly operating as a renegade or without the company's knowledge.

Are the Justice Department's criticisms valid? How do you view the Justice Department's suggestion that S.430 be revised to reflect these concerns?

Answer to Question No. 3:

There is no easy way to get around the problem which has been identifiifed by the Justice Department. The problem is with the court's interpretation of the FCPA. I am confident that the Justice Department can litigate the correct solution in the courts. We have here a lawyer's issue which should not hold up Congressional action on S.430.

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Question No. 4:

Section seven of S.430 contains an exclusivity provision that prohibits use of mail and wire fraud statutes for enforcement actions of the Act's anti-bribery provisions. This is intended to ensure that the Justice Department use the FCPA as the sole enforcement tool for foreign bribery and to avoid end runs of the FCPA.

The Justice Department argues that the exclusivity provision should specify that the restriction against the use of the mail and wire fraud statutes not extend to cases where the Justice Department determines that it cannot effectively use the FCPA to prosecute subordinate officials or employees - for example, because of the problems created by the Eckhardt amendment (see question 3 above). Where the evidence reveals that despite explicit corporate policy to the contrary, a renegade employee/agent/direct employee/agent/officer of a domestic concern has been bribing foreign officials, Justice believes the mail or wire fraud theory might be the only way to prosecute that individual. The Justice Department also contends that any restriction on the government's choice of charges should not apply to plea bargaining.

Are the Justice Department's criticism valid? How do you view the revision advocated by the Justice Department?

Answer to Question No. 4:

As ECAT earlier testified, whatever the legal merits of applying more than one statute to the same conduct, there is now a sound basis in policy for providing expressly that the FCPA alone governs when a foreign governmental bribe is subject to criminal prosecution in the United States. The wire and mail fraud statues are, at best, blunt instruments for attacking improper overseas payments. They reflect none of the careful consideration of relevant trade and foreign policy issues which Congress addressed in 1977 during the legislative process leading to the FCPA and is currently reviewing. Moreover, there is precedent for moving beyond the wire and mail fraud prohibitions with more explicit legislation shaped to respond to a specific problem before the nation. This was the pattern with the response to improper practices in connection with securities transactions and interstate land sales. Initially, U.S. prosecutors relied on the mail or wire fraud statutes. Ultimately, the Congress approved specific legislation directed at these problems after a careful examination of the relevant facts.

I fear that the revision advocated by the Justice Department would amount to an end run on the Eckhardt amendment.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM
CALMAN J. COHEN

Question No. 1:

Doesn't a factor such as the relative strength or weakness of the dollar at any given time have more impact on our ability to compete in overseas markets that the perceived uncertainties in the FCPA? Thus, won't the recent drop in the value of the dollar result in the creation or retention of jobs in the U.S. than any amendments to the FCPA?

Answer to Question 1:

The answer to both questions is "yes." We in ECAT recognize that the value of the U.S. dollar vis-a-vis foreign currencies is a greater factor -- indeed one of the major factors -- in U.S. international competitiveness. At the same time, we believe that the elimination of significant export disincentives, such as the ambiguities in the FCPA, can make an additional contribution to increasing U.S. exports.

The case for reform of the FCPA is not limited to the contribution it would make to the trading interests of the United States. Business people as citizens who are being encouraged by the government to increase exports should not be put at risk of prosecution by ambiguities in the law.

Question No. 2:

In testimony cited before this Committee on Febuary 24, 1983, ECAT estimated that over 60,000 American jobs were lost and $2 billion in sales. How much of this could be attributed to economic factors such as the increase in the dollar's value as to the inconveniences imposed upon businesses by the FCPA?

Answer to Question No. 2:

The figure of $2 billion referred to in ECAT testimony is not based upon increases in the dollar's value. We noted in our testimony that while in few cases could it be demonstrated that the FCPA ambiguities were the sole cause for losses of business, ambiguities of the FCPA were identified by a number of ECAT companies as a factor in losses of business totalling over $2 billion.

Question No. 3:

To estimate the effects of the FCPA upon American business, can you provide information on the impact of the FCPA on companies that have settled suits with the SEC or have been sanctioned under the Act? Have these companies lost jobs or sales to their overseas competitors?

Answer to Question No. 3:

Such specific information is not available to me. My concern is with the ambiguities in the FCPA that potentially affect all busineses. These ambiguities have an inhibiting effect on business and should be clarified as proposed in S.430.

Question No. 4:

How would the specific provisions of S.430 operate to foster increased exports by improving our ability to compete with foreign competitors?

Answer to Question No. 4:

The basic way in which the provisions of S.430 would improve the ability of U.S. companies to compete would be through clarifying and simplifying current law. Two provisions of S.430 are illustrative. First, S.430's establishment of a clear line of liability for third party conduct would improve the ability of U.S. firms to make decisions about the employment of agents without putting the firm itself in unintended jeopardy. Under current law, responsibility attaches under the "reason to know" provision regardless of whether the U.S. business intends to have a third person make an improper payment. The ambiguity of current law leads some companies to refuse to seek business contracts.

Second, in clearly defining what are facilitating and expediting payments -- payments which were never intended to be prohibited under the FCPA -- S.430 would remove uncertainty about business practices and thereby reduce for business the potential jeopardy of doing business abroad.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM CALMAN J. COHEN

Question No. 1:

During our June 10 hearing I asked whether the Department of Justice in the Ford or Carter administrations was opposed to the "reason to know" standard in the FCPA. You stated that "during the Carter administration, the FCPA, and in particular the reason to know provision, was identified as one of the major export disincentives facing American business". That was not a direct answer to my question, so let me ask it again. Did the Justice Department, in either the Ford or Carter administrations, oppose having the "reason to know standard in the FCPA"?

Answer to Question No. 1:

I am not aware of the particular positions on "reason to know" taken by the Justice Department during either the Ford or the Carter Administrations. It was only during the Carter Administration that problems with the "reason to know" concept became evident as experience was gained with the FCPA. Officials in the Carter administration who had primary responsiblity for international trade matters began to identify the ambiguities in the FCPA, particularly the "reason to know" standard, as significant export disincentives.

Question No. 2:

At our June 10 hearing Deputy Assistant Attorney General John Keeney said the Justice Department has prosecuted 25 criminal cases under the FCPA's "reason to know" standard. Does ECAT claim or are you aware whether any of those prosecutions were unjust and should not have been brought?

Answer to Question No. 2:

I do not know the facts in these prosecutions but presume they all should have been brought.

ECAT's concern is with the general inappropriateness of the "reason to know" standard for the establishment of liability for third party payments. As we earlier noted, the provision causes serious problems because it imposes criminal liability on U.S. companies for the actions of others abroad and does so without establishing clear standards for the U.S. companies to follow. Responsibility attaches under this provision regardless of whether the U.S. business intends to have the third person make an improper payment. American business is asked to determine with certainty that third parties abroad will not engage in certain conduct and to risk criminal prosecution if the judgment turns out to be incorrect.

Question No. 3:

Numerous federal statutes, including laws that have criminal sanctions for violating them, have a "reason to know" standard of responsibility. Courts have experience in using that standard and their decisions as to its meaning set forth a clear line for corporate conduct. In sharp contrast the "course of conduct" standard used in S.430 is not widely used in other statutes and has received little if any judicial interpretation. In light of these facts how can you contend that S.430's "course of conduct" standard is clearer than the reason to know standard in current law?

Answer to Question No. 3:

As for the "reason to know" standard, you are correct to note that it is used in other statutes; however, these statutes are not designed to indicate what foreign parties may or may not do. In addition, I am concerned that the "reason to know" standard in the FCPA can serve as the basis for imposing criminal penalties for what are negligent violations. This is, according to modern criminal law, a most inappropriate application of the "reason to know" standard.

ECAT members believe that the preferable standard would be to impose liability if a U.S. business has circumvented the bribery prohibition of the FCPA by directing or authorizing a third party to make an improper payment. That language would establish a clear, bright line of liability for third party conduct. It is my understanding that the "course of conduct" language was added for the purpose of clarification, i.e., indicating that the totality of action of business is to be taken into account in order to determine intent.

Question No. 4:

While you repeatedly stated in your testimony that the "reason to know" standard creates serious problems of uncertainty for American exporters, you gave only one example of a situation that you claim would be ambiguous under current law. In that example on page 5 of your prepared testimony you cite the case of U.S. exporters selling manufactured goods to a foreign dealer who is responsible for their resale. In such a situation you claim the U.S. exporter would have minimal involvement in the marketing of the products and no equity or other financial interest in the dealer's operations. Under whose interpretation of the FCPA, in such a case, could the U.S. company be prosecuted for unconnected future actions of the foreign dealer? Has the Justice Department ever brought such a case or made any claim that such a situation would violate the FCPA? How do you see the standard of conduct for agents in S.430 helping U.S. exporters in such a situation?

Answer to Question No. 4:

The situation which I cited is a hypothetical which could give rise -- inappropriately I would suggest -- to a prosecution because of the

ambiguity of the "reason to know" provision. The standard of liability in S.430 would help U.S. exporters in such a situation because the extent of their responsibility would be more clearly defined. They appropriately could be held liable for directing or authorizing, expressly or by a course of conduct, illicit payments to a foreign government official. This is a standard that is far more workable than that in current law.

The case I presented is one with which business is concerned. No business wants to rely on Department of Justice discretion to prosecute. Business supports S.430 because it will clarify current law.

Question No. 5:

On page 8 of your testimony you refer to the provisions of S.430 which set forth exceptions to the prohibition on bribery. There are 5 such specific exceptions in S.430. Do you think any of those exceptions are overbroad? If so which ones?

As a follow up I note that on April 16 you testified in the House about changes to the FCPA. Mr. Steve Brogan a partner with the distinguished law firm of Jones, Day, Reavis and Pogue was with you to also testify in favor of changes to the FCPA. At that hearing Mr. Brogan mentioned the five facilitating payment exceptions in S.430 and said you could drive a truck through two or three of them.

Did you hear Mr. Brogan say that? Do you think we should identify those loopholes and plug them so companies are not inadvertently given permission to bribe to win business?

Answer to Question No. 5:

No, I do not think the exceptions are overly broad. The so-called exceptions in S.430 were drawn to deal with specific business situations. They clarify what are to be considered permissible actions. Payments by U.S. firms to foreign government officials to obtain or retain business are prosecutable under current law and would continue to be prosecutable under S.430.

At the same time, I recognize that almost any legislative language can be fine-tuned and clarified in legislative history. I certainly would be interested in hearing the specific recommendations of Mr. Steve Brogan for whom I hold the highest professional regard.

Question No. 6:

Deputy Assistant Attorney General John Keeney testified on June 10 that all five "grease payment" exceptions in S.430 needed to be tightened up and he suggested language for each one to do that. Do you agree with the additional language he suggested for each exception? If not, why not?

4
PROXMIRE--COHEN

Answer to Question No. 6:

First, Deputy Assistant Attorney General Keeney would support legislative history definitions of what can and cannot be considered a routine governmental action. ECAT would support this recommendation.

Examples of routine governmental action that could be included in legislative history are: (1) processing governmental papers, such as visas and work orders, (2) loading and unloading cargoes, and (3) scheduling inspections associated with contract performance. Further, legislative history could clarify that routine governmental action does not encompass either the obtaining or retaining of business.

Second, Deputy Assistant Attorney General Keeney would convert into an affirmative defense the exception in S.430 for payments which are lawful under the laws and regulations of a foreign official's country. ECAT believes that burden of proof in a prosecution should rest with the government as it has traditionally and for that reason does not support the Keeney recommendation. Companies are aware that if the government successfully demonstrates that a case should go forward, it will fall to them to make the necessary defense.

Third, Deputy Assistant Attorney General Keeney recommended the development of a legislative history on the exception for payments which constitute a "courtesy, a token of regard or esteem, or in return for hospitality." ECAT would support a clarification in the legislative history that a particular dollar value was not placed on such payment in recognition that local customs and practices vary. The decision on the appropriateness of any such payment could not be made solely on U.S. dollar value; the question would be whether the value was appropriate to the circumstance.

And fourth, there are the recommendations of Deputy Assistant Attorney General Keeney for a clarification of the remaining two exceptions. I believe that both are appropriate for the legislative history.

Question No. 7:

You stated at our June 10 hearing that S.430 "makes sure that there is an adequate recording of the assets and that the assets are correctly disposed of". Since the adequate accounting systems required by the FCPA are designed to prevent corporations from building "off the books slush funds" why should not a "knowing" failure to have such an adequate system in place be subject to criminal penalties?

Answer to Question No. 7:

ECAT believes that penalties imposed under the FCPA should distinguish failure to comply in good faith with the internal

accounting control requirements of the Act from knowing circumvention of a system of internal accounting controls established by a company to achieve the statutorily specified objectives of the Act. Application of a criminal standard to compliance with the internal accounting control requirements would be inappropriate because any finding of compliance depends on judgments of what would be considered "reasonable detail" and "reasonable assurance." Further, criminal penalties should be imposed only for the more serious offense which is knowing circumvention.

ECAT supports the accounting provisions in S.430, as does the Securities and Exchange Commission witness who testifed before the Committee.

Question No. 8:

During our June 10 hearing corporate defense attorney Arthur Mathews stated that the FCPA has "had a tremendously positive effect on corporate America". He continued "in my 24 years of practice, I cannot think of any statute that has had a more significant effect in raising the level of corporate accountability in this country. This statute has caused corporate America to engage in healthy self-analysis and self-investigation and has substantially upgraded the standards of corporate conduct of both public and private companies ... The proposed amendment in S.430, by significantly narrowing the scope of Section 13(b)(2), will needlessly curtail the SEC's cooked book cases."

In light of the tremendous benefits the FCPA's accounting procedures have brought to our society, why does ECAT support changes to narrow their scope and effectiveness?

Answer to Question No. 8:

As I noted in my testimony, ECAT supports S.430 because it would clarify, among other things, the reach of the accounting provisions in current law without weakening the ability of the FCPA to address successfully the problems which were identified at the time the law was enacted. Wrongful conduct would continue to be prosecuted under S.430.

Question No. 9:

In your June 10 testimony you stated that ambiguities in the FCPA's accounting standards have created unnecessary compliance costs. However in 1981 Harold Williams, then Chairman of the SEC, issued a clear and concise statement regarding the requisite level of detail and accuracy that was needed in corporate books to comply with the FCPA's accounting provisions. Do you know of any situation in which the SEC or Justice has deviated from the Williams statement in implementing the FCPA's accounting provisions?

Answer to Question No. 9:

No, I do not.

I believe that the revisions of the accounting provisions in S.430 attempt to incorporate into the basic statute some of the recommendations of former SEC Chairman Williams.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM
ALLEN B. GREEN

Q1: Mr. Keeney of the Justice Department argued that section 104(a) of the foreign payments provisions of S. 430 should not omit agents from those covered by the Act's anti-bribery provisions. Mr. Keeney contends that retention of agents within the Act's coverage provides an important enforcement tool for those that fall within this group. On the other hand, many small and medium-sized businesses complain that they do not have the time and money needed to assure themselves that an export transaction handled by an agent will not result in criminal liability under the Act.

How important do you view the deletion of agents from the Act's coverage as a signal to businesses that they will not be held vicariously liable for the criminal activity of others?

A1: The omission of a reference to agents in section 104(a) of S. 430 should not be read as a signal that use of agents will insulate U.S. businesses from vicarious liability for criminal activity. Liability of U.S. companies for using third parties, such as agents, to bribe foreign officials has always been covered by the FCPA and will continue to be covered under S.430. The only effect of this omission is to make it clear that a company's vicarious liability will result from the standard set forth for third party payments in § 104(b).

Accordingly, this omission does not in any sense do away with vicarious liability and would not affect the FCPA requirement that U.S. businesses police the activities of their foreign agents.

Q2: Mr. Keeney also argued for removal of the provisions in S. 430 requiring binding opinions and enforcement guidelines from the Justice Department. Critics of the Act's present review procedure contend that there is a need for the Attorney General to issue binding advisory opinions in regard to specific inquiries concerning foreign payments.

How important do you view the provisions in S. 430 requiring the Justice Department to issue binding advisory opinions concerning foreign payments? (An advisory opinion would be issued with the caveat that it be valid only insofar as it is not at variance with the facts on which the opinion was based.)

A2: The provisions of S. 430 requiring the Justice Department to issue binding advisory opinions would be very valuable in encouraging and facilitating compliance with the anti-bribery provisions of the FCPA. The chief problem with the present advisory opinion process at the Department of Justice is its generality, which is compounded by the difficulty of determining precisely what transactions are proscribed by the FCPA. U.S. businesses are faced with the task of attempting to tailor their activities to a law with unclear limits, and have not been particularly benefitted by advisory opinions limited to specific facts (not all of which are disclosed to the public) which do not elaborate upon the law but merely promise not to prosecute. The

questionable value of these advisory opinions, either as protection for the requestor or as precedent for other businesses, has severely limited the number of such opinions issued, so that what little educational value they could have for other businesses is largely lost. Issuance of binding opinions and development of enforcement guidelines would force the Department of Justice to establish a body of interpretive law to guide U.S. business activity abroad and are significant benefits offered by S. 430.

Q3: In both the FCPA and S.430 there is a provision (the Eckhardt Amendment) prohibiting the conviction of an employee of a domestic concern unless the domestic concern itself is "found to have violated" the Act. The purpose of the provision is to prevent a company from labeling an employee a renegade, thereby using him as a scapegoat for the company's criminal acts. The Justice Department finds this language deficient, because it has been too strictly interpreted by the courts: a company must have been actually convicted to allow an enforcement action against one of its employees; and a company that enters a guilty plea is not "found to have violated" the Act. The Justice Department argues that companies can plead guilty to an FCPA violation without being convicted, and leaving the employee or agent to defend himself. They advocate correcting this problem by adding language requiring a company to indemnify an employee's attorney's fees unless it can prove that the employee was clearly operating as a renegade or without the company's knowledge.

Are the Justice Department's criticisms valid? How do you view the Justice Department's suggestion that S.430 be revised to reflect these concerns?

A3: The Justice Department's criticisms of the Eckhardt Amendment with regard to the effect of company guilty pleas appears to be unfounded. The result in United States v. McLean, 738 F.2d 655 (5th Cir. 1984), cited as an example of such a problem, in reality reaches precisely the result which the Eckhardt Amendment was designed to achieve. In that case, the Justice Department chose to accept a company's guilty plea to a charge of conspiracy rather than pursue alleged substantive violations, (e.g., bribery) and then sought to convict two employees of those substantive violations (not conspiracy) without ever having proved those violations against the company or even receiving a guilty or no contest plea.

The court decided that because of the Eckhardt Amendment the Justice Department must first obtain a conviction of the company for the specific substantive violations alleged against individuals. The court did not hold that a guilty plea is not a conviction, but rather only that a company plea of guilty to a conspiracy charge is not the same as a company plea of guilty to a bribery charge. The position unsuccessfully urged by the Justice Department in McLean, under which it attempted to "prove" violations against the company in the proceedings against the employees, would subject individuals to the burden of defending against alleged but unproven company acts. In

essence, they would have to defend the company as well as themselves, but without access to information the company might be able to present were it required to conduct its own defense. If, as the Justice Department claims, it had uncontrovertible proof of company and individual violations, acceptance of a plea from the company in that case only on the charge of conspiracy demonstrated a failure of enforcement tactics and not a flaw in the FCPA. A plea bargain on the substantive counts would have preserved the charges against the employees in that case, but a plea on a different crime, conspiracy, did not.

Q4: Section seven of S.430 contains an exclusivity provision that prohibits use of mail and wire fraud statutes for enforcement actions of the Act's antibribery provisions. This is intended to ensure that the Justice Department use the FCPA as the sole enforcement tool for foreign bribery and to avoid end runs of the FCPA.

The Justice Department argues that the exclusivity provision should specify that the restriction against the use of the mail and wire fraud statutes not extend to cases where the Justice Department determines that it cannot effectively use the FCPA to prosecute subordinate officials or employees -- for example, because of the problems created by the Eckhardt amendment (see question 3 above). Where the evidence reveals that despite explicit corporate policy to the contrary, a renegade employee/ agent/direct employee/agent/officer of a domestic concern has been bribing foreign officials, Justice believes the mail or wire fraud theory might be the only way to prosecute that individual. The Justice Department also contends that any restriction on the government's choice of charges should not apply to plea bargaining.

Are the Justice Department's criticism valid? How do you view the revision advocated by the Justice Department?

A4: Prior to enactment of the FCPA, the Justice Department in several instances prosecuted companies and individuals under, it was commented at the time, strained interpretations of various criminal fraud statutes, such as mail and wire fraud. One reason the FCPA was enacted was to provide a specific vehicle for criminalization of foreign bribery. To permit prosecution under other statutes now, for the conduct specifically proscribed by the FCPA, would only remove certainty in this area at a time when the Congress intends to achieve certainty.

With regard to the utility of Justice's suggestion insofar as the Eckhardt Amendment is concerned, the issue apparently is that although Justice may choose not to prosecute a company under the FCPA, it still may wish to make creative use of, e.g., mail fraud and wire fraud statutes to pursue individual violators. Companies, however, are composed of individuals. A better approach, if the Department does not perceive that the facts justify prosecution of a company, may be to drop the case altogether.

Let us assume, however, that in particular instances justice would be better served by prosecuting "renegade" employees without prosecuting the company that employs them. Although the ABA Public Contract Section takes no position on the advisability of such an amendment, a more direct solution, if Congress agrees with Justice and wishes to address this issue,

may be to delete the Eckhardt Amendment outright rather than to permit overly broad use of other criminal statutes, the expansion of which could have ramifications far beyond the defects perceived by Justice in the Eckhardt Amendment.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM
ALLEN B. GREEN

Q1: Would the imposition of civil liability be insufficient if criminal liability was eliminated for violations of the Act's accounting provisions?

A1: No. Civil liability is a powerful encouragement of compliance with the FCPA. Civil penalties are a more appropriate method of dealing with the accounting provisions, in order to avoid criminalizing merely negligent or inadvertent recordkeeping errors. Criminal liability will be available, as always, for intentional violations of the basic securities laws and FCPA antibribery provisions.

Q2: S.430 would require that no liability under the accounting provisions would attach to a covered entity that can demonstrate "it acted in good faith in attempting to comply" with the new statutory requirement. Would this "good faith" defense effectively eviscerate the accounting provisions of S.430?

A2: No. The effect of this provision would be to insulate issuers from simple acts of inadvertence. Even the best of internal control systems may unintentionally malfunction. No system reasonably can be expected to work perfectly all of the time. An exemption for good faith efforts to assure compliance will prevent penalization of oversights, mistakes, and other inadvertent acts, while encouraging adoption of sufficient internal controls to sustain a claim of good faith efforts, thus promoting

substantially upgraded compliance efforts. Meanwhile, intentional circumvention of the recordkeeping requirements by officers or employees, despite good faith compliance efforts by the issuer, will be penalized by the proposed revision to 13(b)(6). No "evisceration" would thereby be effected by this good faith exemption to the recordkeeping requirements.

Q3: What enforcement difficulties could result from replacing the "reason to know standard" with the standard in S.430 making it illegal for a principal of a domestic concern "to direct or authorize, expressly or by a course of conduct" a third party in furtherance of a bribe?

A3: The proposed replacement of the "reason to know" standard would in some ways ease enforcement of the FCPA, by shifting the focus from a vague standard that potentially criminalizes mere negligence, or less, to factual proof of the authorization or direction of an act of bribery. S.430 relies less on what a company or person should have known or discovered, and more on the fact of a person's active participation in or consent to an act of bribery.

S.430 may in fact be easier and fairer to enforce than the "reason to know" standard, as a more appropriate basis for imposing criminal penalties. However, as with the "reason to know" standard, the standard in S.430 does not rely upon traditional U.S. law criminal culpability

standards. It is for this reason that an actual "knowledge" standard was suggested by the Section of Public Contract Law of the American Bar Association. This standard has an accepted definition already understood by judges, coming as it does from traditional criminal law mens rea concepts, and substantial underlying case law to support it and guide its application to the facts of a particular case. It further incorporates, as do neither the FCPA nor the S. 430 standards, the concept of "willful blindness," or purposeful ignorance, as a basis for establishing knowledge.

Q4: S.430's bribery provisions would exclude from liability business organizations that are not publicly traded. Would this provision allow the non-public subsidiaries of public companies to pay bribes with impugnity? Why should this be any distinction between nonpublic and public companies regarding their respective abilities to pay bribes?

A4: Companies that are not publicly traded are not excluded from the antibribery provisions of S.430, which apply to "domestic concerns." The bill defines "domestic concern" as:

> (A) "any individual who is a citizen, national or resident of the United States . . .; or (B) any corporation, partnership, association. . . unincorporated organization, or sole proprietorship which has its principal place of business in the United States, which is organized under the laws of a State of the United States. . . ., which has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, or which is required

> to file reports under Section 15(d) of the Securities Exchange Act of 1934." (emphasis added).

S.430 § 104(f)(1). Several of the listed business entities, e.g., unincorporated organizations and partnerships, are by definition not "publicly traded." In fact the criteria for domestic concerns are stated in the alternative, so that registration with the SEC is not a prerequisite to FCPA coverage. The antibribery provisions in S.430 would reach both public and non-public companies, as is the case with the current law.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR PROXMIRE FROM ALLEN B. GREEN

Q1: On page 27 of your testimony you refer to the changes that S.430 would make in the "grease payment exception" already in the FCPA and note that such changes would "lead to ambiguity as to the purpose and intent of the Act itself and to questions of its legal enforceability" ... "and places Congress in the position of condemning bribery on the one hand while listing numerous exceptions to the rule on the other".

I take it you disagree with Secretary Baldrige who referred to the changes S.430 would make in the grease payment exceptions and said "these clarifications are the sort of reforms which should help U.S. executives understand what their obligations are under the law".

Do you disagree with the Secretary? Do you think enactment of the five exceptions to the prohibition on bribery contained in S.430 would make it more difficult for prosecutors to win convictions for bribery under the FCPA?

A1: We do not disagree with the Secretary. The concern expressed in the quoted remarks does not refer to additional difficulty in obtaining convictions for bribery under the FCPA. Indeed, certainty under the law -- and thus convictions -- would be fostered with the provision of precise descriptions of exempt activities rather than imprecise language, contained only in the legislative history of the FCPA, to govern enforcement efforts. Rather, the concern of the Public Contract Law Section is that by enumerating types of payments which are always legal, certain payments actually intended as bribes nonetheless may be exempted outright, and otherwise proper payments inadvertently excluded. No list can be perfect.

For this reason, the Section suggested that the adoption of a specific intent to bribe as one element of the bribery offense would be more helpful than a group of defined exceptions. With intent as a requirement, it would not be possible to avoid penalties by claiming a payment is one of the listed exemptions if the payment is intended as a bribe to obtain government business. Conversely, a payment not currently listed in S. 430 as an exception to coverage, if not made with the intent to bribe, would not be penalized. We believe that such an approach better serves the policy goals of the FCPA of prohibiting any form of bribery.

As Secretary Baldrige has suggested, there is need for clarification to help U.S. executives understand their obligations under the law. It is merely the form that this clarification takes which should be reconsidered. The Section suggests adoption of an intent requirement. Certainly this could be used as a corollary to a list of illustrative exceptions. However, as noted on page 29 of our statement, if a list of exceptions is to be adopted, that of S.430 is preferable to the list of "defenses" in the FCPA amendments of H.R. 4800.

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PROXMIRE--GREEN

Q2: You stated at the June 10 hearing that the FCPA's "accounting standards section is there to require legally the internal controls that a corporation should have in place ..." The FCPA required such controls in order to prevent corporations from building "off the books slush funds". Why should Congress not continue to provide that a "knowing failure" to have an adequate accounting system in place be subject to criminal rather than just civil penalties?

A2: In fact, substantial civil penalties are in place to discourage inadequate recordkeeping by companies subject to the FCPA. Civil enforcement of the accounting provisions is appropriate because the goal is to assure that corporate assets are correctly disposed. There is no need to criminalize the FCPA accounting provisions, and it is in fact inappropriate, because it has the effect of imposing criminal penalties on activities that may be merely negligent or inadvertent and that may not relate to the antibribery policy underlying the FCPA.

The FCPA policy of preventing bribery is criminally enforced in the antibribery provisions, and, if it is desirable to pursue a particularly egregious violation of the accounting provisions, criminal penalties are available under other provisions of the securities laws, such as the anti-fraud provisions. Thus, no act of malfeasance will escape an appropriate penalty, and investors will still have corporate records of sufficient accuracy to rely upon if S. 430 is enacted.

4
PROXMIRE--GREEN

Q3: In your testimony you cite numerous statutes that use the "reason to know" standard, and court cases, each of which interpret the standard in exactly the same way. Could you please provide a similar analysis of the "course of conduct" standard included in S.430.

I know that your committee greatly prefers the adoption of the "knowing" standard for the bribery provisions. However, if you had to choose between "reason to know" or "course of conduct", which would you prefer?

A3: The standard proposed to replace "reason to know" in S.430 is "direct or authorize, expressly or by a course of conduct." This new language avoids many of the difficulties observed with the "reason to know" standard, which has been challenged because it is an ambiguous and inappropriate basis for criminal liability. The ambiguity of the reason to know standard is reduced under the S. 430 standard by shifting the emphasis from the perceptions of a person to affirmative acts or omissions. This adjustment accordingly should bring the FCPA closer to the standard treatment of criminal activity under U.S. law.

However, the S.430 language, like "reason to know," is untested by the courts and subject to uncertain interpretation in the criminal context. In both instances Congress has sought to criminalize acts of foreign bribery but has not applied the same standards of criminal intent that customarily are contained in the U.S. crminal codes. Such an approach fosters uncertainty in the law.

With regard to your request for an analysis of the S.430 standard for third party payments, we note that there is little appropriate precedent for criminal enforcement of that language. Certainly, as a general rule, affirmative acts or omissions are the traditional bases for criminal liability. The Model Penal Code states this principle succinctly: "A person is not guilty of an offense unless his liability is based on conduct which includes a voluntary act or the omission to perform an act of which he is physically capable." Model Penal Code § 2.01. "Conduct" is defined in the Model Penal Code as "an action or omission and its accompanying state of mind, or, where relevant, a series of acts and omissions." Model Penal Code § 1.13. The express direction or authorization required by S. 430 would seem to be in accord with this fundamental principle.

Using a "course of conduct" to ascertain a specific act, such as an authorization, has been used in U.S. laws and regulations. However, as with "reason to know," most of these usages are civil, not criminal. See, e.g. 8 U.S.C. § 1252; 15 U.S.C. § 1127; 15 U.S.C. § 1294; 18 U.S.C. § 1514; 18 U.S.C. § 2403-1a(6); 28 U.S.C. § 1603(d); 7 C.F.R. § 46.45; 13 C.F.R. § 103.13-5; 13 C.F.R. § 309.7; 15 C.F.R. § 0.735-15; 15 C.F.R.

§ 369.2(3),(9); 15 C.F.R. § 369.4; 16 C.F.R. § 15.28; 24 C.F.R. § 3500.14; 26 C.F.R. § 1.269-3.

As you are aware, the Public Contract Section of the ABA strongly believes that the shift in emphasis to affirmative acts in the FCPA should be accompanied by the adoption of a standard of culpability traditionally used in criminal law, and for this reason has advocated adoption of a "knowledge" standard for acts of bribery. The standard encompasses deliberate ignorance of acts of bribery, which is not clearly covered by either "reason to know" or "direct or authorize, expressly or by a course of conduct." It is further a standard which, unlike either of these standards, has long been in use by the courts, charged to juries, and would not be subject to varying interpretations.

In reference to your request that, despite our preference for a new standard, we nevertheless choose between the standard presently in the FCPA and that in S.430, we would choose "direct or authorize, expressly or by a course of conduct." Adoption of the "direct or authorize" standard is not the ideal solution to this problem, but is a distinct improvement over the "reason to know" standard in its treatment of U.S. companies operating under the FCPA. If this standard were to be used, we would

recommend the legislative history go into some detail on the intended scope of this standard.

In conclusion, however, we see no reason why the mens rea for the criminal provisions of the FCPA cannot be the same as for virtually every other U.S. criminal statute, including the domestic bribery statute. As in any other criminal statute, this certainty would make for effective deterrence and better enforcement.

U.S. CHAMBER OF COMMERCE

William T Archey
Vice President, International

June 26, 1986

The Honorable Jake Garn
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Recently, Senators Heinz and D'Amato held subcommittee hearings on S. 430, the Business Accounting and Foreign Trade Simplification Act. The Chamber welcomes this opportunity to comment on S. 430. This legislation represents a long-overdue effort to clarify unintended ambiguities in the Foreign Corrupt Practices Act (FCPA) which, taken together, pose significant disincentives to U.S. exports and overseas investment. The Chamber strongly endorses the FCPA's objective of eliminating American corporate participation in corrupt business practices. Such practices tarnish the U.S. business community's reputation and, in the long run, actually undermine American business and foreign policy interests. Nonetheless, the 1977 FCPA includes provisions which unnecessarily impair U.S. business performance in oversees markets. The Chamber believes that the FCPA can and should be amended in a manner which removes unwarranted impediments to U.S. business while adhering to the original purpose of the FCPA.

In 1981, the Chamber issued a report entitled The Price of Ambiguity: More Than Three Years Under the Foreign Corrupt Practices Act, which includes numerous examples of business opportunities foregone because of the FCPA. A copy of that study is enclosed for the hearing record. Similarly, in 1981, the General Accounting Office performed a study, entitled Impact of Foreign Corrupt Practices Act on U.S. Business, which is currently part of the Banking Committee's hearing record. The GAO report was based on information obtained from a survey of 250 companies randomly selected from Fortune's list of the 1,000 largest industrial firms. The response rate was 75%. Among other things, over 30% of the responding firms engaged in foreign business reported that they had lost overseas business as a result of the FCPA.

The Chamber believes that approval of S. 430 would represent significant progress toward removal of important export and investment disincentives facing U.S. business. We note that, for the first time since the FCPA's enactment, standing committees in the House of Representatives have also approved constructive changes in that Act. Those changes were included in H.R. 4389, the Foreign Trade Practices Act, and approved by the House of

Representatives on May 22 as part of H.R. 4800, the House omnibus trade bill. I am enclosing a copy of our testimony on H.R. 4389, presented to the Subcommittee on International Economic Policy and Trade of the House Committee on Foreign Affairs on April 16, 1986.

We would also note that language identical to S. 430 has been included as part of Title IX of S. 1860, the Senate omnibus trade bill currently awaiting consideration.

The Chamber would be happy to work with the Banking Committee and, later, with Senate and House conferees to develop language which advances U.S. business and foreign policy interests. Your consideration of the Chamber's position is respectfully requested, and I ask that this letter and attachments be entered into the hearing record.

Sincerely,

William T. Archey

Enclosure

cc: Committee members

Statement of the Chamber of Commerce of the United States

ON: THE FOREIGN TRADE PRACTICES ACT
(H.R. 4389)

TO: SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE OF THE HOUSE COMMITTEE ON FOREIGN AFFAIRS

BY: WILLIAM T. ARCHEY

DATE: APRIL 16, 1986

The Chamber of Commerce of the United States is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents approximately 180,000 businesses plus several thousand organizations, such as local/state chambers of commerce and trade/professional associations.

More than 91 percent of the Chamber's members are small business firms with fewer than 100 employees, 57 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business--manufacturing, retailing, services, construction, wholesaling, and finance--numbers more than 12,000 members. Yet no one group constitutes as much as 29 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 56 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
THE FOREIGN TRADE PRACTICES ACT
(H.R. 4389)
before the
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE
of the
HOUSE COMMITTEE ON FOREIGN AFFAIRS
for the
U.S. CHAMBER OF COMMERCE
by
William T. Archey
April 16, 1986

I am William T. Archey, Vice President, International, of the U.S. Chamber of Commerce.

The U.S. Chamber welcomes this opportunity to comment on legislation to amend the Foreign Corrupt Practices Act (FCPA) of 1977, ambiguities of which are a source of concern for the U.S. business community. We commend Representative Dan Mica for assuming leadership on this important issue. His initiative builds upon the record established with Senate passage of S. 708 in the 97th Congress and which continues today with bipartisan support of S. 1860, the Trade Enhancement Act of 1985, which includes those provisions. On September 23, 1985, the Administration stated that it will again seek legislation to remove the export disincentives in the Foreign Corrupt Practices Act.

H.R. 4389 follows in that spirit. We hope that its consideration will serve as a catalyst for meaningful action toward elimination of ambiguous and uncertain FCPA requirements.

Clarification of the FCPA is long overdue. We endorse that law's objective of eliminating bribery and extortion which exists in many parts of the world. The Chamber opposes corrupt practices. They do not serve the nation's political or economic interests, and they do not serve the commercial interests of the American business community. On the contrary, American business does best when it concentrates on competitiveness, not corruption.

I am here today because certain provisions of the 1977 FCPA include statutory language that unnecessarily impairs the international competitive performance of American business. The law's intent, which the Chamber shares, can be achieved without ambiguities and without stifling legitimate entrepreneurship. Ambiguities in the act's language deter American businessmen from overseas investment because they do not know when they might inadvertently violate vague statutory standards.

Key provisions of the FCPA contain language that is ambiguous and confusing, not only to businessmen, but to lawyers and accountants -- those professionals to whom businessmen must turn for guidance on compliance. Neither the FCPA's legislative history nor the policy statements and regulations issued by the Securities and Exchange Commission and the Department of Justice have provided adequate guidance for proper conduct under the act. The record keeping and internal control provisions use vague language in setting the accounting standards that the reporting companies must meet. The anti-bribery provisions of the act are perhaps even more unclear and do not take into consideration the variations in business practices from country to country.

This is poor national policy even in the best of circumstances. But, with a record merchandise trade deficit of some $149 billion, and an unprecedented current account deficit of some $118 billion, the United States obviously faces a real challenge. The international accounts deficits clearly indicate that U.S. businesses face formidable challenges from foreign competitors in world markets; many U.S. sectors are losing world market share. Moreover, they face these competitive challenges at a time when domestic economic growth depends more than ever before on America's foreign trade and investment performance. At a time when exporting is so important to economic recovery, and when there are mounting pressures for increased protectionism and retaliation in response to fair and unfair foreign competition, it makes no sense to erode America's competitive ability by burdening it with the murky provisions of the FCPA.

To restore growth and employment to U.S. international activities, greater incentives to risk-taking and long-term business strategies are needed, not legal ambiguities that signal businessmen to leave well enough alone. The effect of the FCPA should be to check corruption, not entrepreneurship. Finally, until America has a comprehensible national law, it will find it difficult to persuade foreign governments to cooperate in establishing multilateral rules on payments.

In 1981, the Chamber published a report on the FCPA which contains a collection of case studies that illustrate the FCPA's unintended effects, which have cost U.S. firms foreign business opportunities. The report, entitled The Price of Ambiguity: More than Three Years Under the Foreign Corrupt Practices Act, indicates that the FCPA has made U.S. companies very hesitant to engage in business in some overseas markets. It also suggests that U.S. firms are disadvantaged because many foreign countries are reluctant to do business with American companies when confronted with the requirements of the FCPA. There are numerous instances when foreign customers, agents, and joint-venture partners have ended their business relationships with a U.S. concern because they feared becoming implicated in U.S. government charges against that U.S. company. Some of the cases illustrate problems that may arise due to U.S. company uncertainty as to the extent of liability for the actions of third parties, such as foreign agents, minority owners of subsidiaries, and joint-venture partners, over which U.S. companies may have little or no control.

U.S. companies also have lost overseas business because they refused to be guided by customary local business procedures which they feared might be questionable under the FCPA. A representative list of such practices, included in the Chamber report, shows that most of these are not within Congress's intended proscription. Many such practices are legal, required by convention, or are considered common courtesy in foreign countries. Failure to conform to them can make business virtually impossible. However, the

effect of the FCPA ambiguities has been to encourage U.S. companies to concentrate their activity in geographic regions where there is relatively little risk of running afoul of the FCPA. One consequence is that U.S. firms are less likely than their foreign competitors to enter the world's fastest growing export markets -- developing countries.

The Mica Bill (H.R. 4389)

We note that Representative Mica's legislation is intended to revise the FCPA in a number of ways. This legislation would include revised anti-bribery provisions of the FCPA in a new section (8A) of the Export Administration Act (EAA). First, H.R. 4389 would substitute a "knowledge" standard for the "reason to know" standard in current law as it pertains to the activities of company agents (third parties). Under current law, companies rarely know when they should have "reason to know" that an agent may be acting in violation. We believe that the proposed "knowledge" standard is offered in recognition of the need to dispel unwarranted business concerns over agent responsibilities, over which expectations of company control are not reasonable. We recommend that the committee further refine this standard so as to ensure that corruption resulting from "head in the sand" behavior, in which unscrupulous companies feign ignorance of prohibited activities, is not sanctioned.

H.R. 4389 also attempts to clarify language concerning permissible payments. It seeks to make clearer that payments which entail the performance of clerical and other routine governmental actions by foreign officials are not prohibited. Payments which are allowable under the laws of the host country also are not prohibited. Current law identifies permissible payments not in terms of their purpose but rather the position of the recipient, i.e., one whose "duties are essentially ministerial or clerical." In many countries, one cannot identify which government positions are "essentially ministerial or clerical." In our view, the approach to permissible payments embodied in H.R. 4389, by referring to the purpose and local legality of the payments, represents a constructive step toward resolution of this problem.

We also note the bill's proposals to (a) assign the Department of Commerce primary responsibility for guidelines and binding opinions concerning compliance questions, (b) include the anti-bribery provisions under the EAA, (c) double applicable penalities under the EAA for violations of the anti-bribery provisions in section 8A, (d) require a Foreign Commercial Service review of the act's impact in countries to principal trading importance to the U.S., and (e) urge negotiation of an international agreement concerning practices prohibited by the act.

All of these proposals merit further attention and study. Practices affected by H.R. 4309 by definition represent an international trade and ethical challenge requiring the attention of all affected governments. Only multilateral efforts can effectively check corrupt practices in international business.

The Chamber believes that U.S. business should set a high standard of conduct. But we must seek new ways to achieve enforceable multilateral rules against bribery. And we should not permit foreign governments the excuse of vague, unworkable U.S. laws to justify their noncooperation. Clarification of the FCPA is essential. This hearing is especially appropriate in the context of omnibus trade legislation, which this subcommittee and others are preparing. We stand ready to assist you in any way we can.

Research Reports

The Price of Ambiguity: More Than Three Years Under the Foreign Corrupt Practices Act

by
Howard L. Weisberg
and
Eric Reichenberg

International Division
Chamber of Commerce
of the United States

The Chamber of Commerce of the United States is the world's largest volunteer business federation. Over 4,000 local and state chambers of commerce and trade and professional associations, more than 100,000 business firms, and American chambers of commerce in 42 locations abroad comprise its strength and depth.

The U.S. Chamber has long been convinced of the vital role of business in international relations and aware of the impact international developments can have on business. As early as 1912, at the time of the U.S. Chamber's second board of directors meeting, the board established a "Foreign Commerce" committee and five subcommittees on international trade.

Today, the U.S. Chamber believes that a basic economic and political feature of the international scene is the interaction of many influences that are propelling all nations to aspire toward a higher, increasingly sophisticated and complex degree of global social, political, economic and scientific interdependence. The challenge facing the United States does not lie in avoiding or combatting these profound forces, but in attempting to influence and guide their direction in ways that minimize friction, avoid confrontation and optimize the benefits that can stem from an economically interdependent world.

New realities of world interdependence create an important international role for the U.S. Chamber on behalf of the nation's business community. The essentials of that role are to seek pragmatically the further development of an interdependent world economy, to minimize economic conflicts and to maximize the social and economic well-being of the American people and people of other nations.

The U.S. Chamber's international activities are carried out by its International Division. The offices of the International Division are located at U.S. Chamber headquarters, 1615 H Street, N.W., Washington, D.C. 20062. (Phone: 202/659-6111). Dr. Michael Samuels is Vice President, International; L. Oakley Johnson is director of the International Economic Affairs Section; Frederick W. Stokeld is Director of the International Economic Policy Section; and John Volpe is Director of the International Research and Special Projects Section.

A brief description of activities and selected publications of the International Division may be found at the end of this publication.

This report continues a special publications series. Quite often, reports are produced by the staff or commissioned for use by the committees, councils and task forces operating under the auspices of the International Division of the U.S. Chamber. Since it was felt that these reports have a wider applicability, the *Research Reports* series was inaugurated. The International Division will from time to time issue *Research Reports* which, it is expected, will contribute to a better understanding of international issues of importance to public and private sector policy makers.

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The Price of Ambiguity: More Than Three Years Under the Foreign Corrupt Practices Act (6468)

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FOREWORD

In December 1977, the Congress enacted the Foreign Corrupt Practices Act (FCPA), a law intended to prohibit corporate bribery of foreign government officials. Since its inception, the FCPA has resulted in lost overseas opportunities for U.S. business. Congress clearly meant for some of these losses to occur, i.e., those related to payments intended to influence officials. However, the FCPA has also cost this country foreign business because of the law's statutory ambiguity and the unclear enforcement priorities of its administering agencies. The vagueness, coupled with the FCPA's severe sanctions, has caused businessmen to be excessively cautious to the point of avoiding situations Congress never intended to reach.

These unnecessary and unintended losses signal the need for clarification of the FCPA. The Chamber of Commerce of the United States, recognizing the need to demonstrate the relationship between statutory ambiguity and lost overseas business, surveyed many of its member companies for specific examples of the causal connection. The resulting study, The Price of Ambiguity: More Than Three Years Under the Foreign Corrupt Practices Act, was prepared by Howard L. Weisberg, the Chamber's Director of International Trade Policy, and Eric Reichenberg, Research Assistant. The authors are indebted to Peter Trooboff of the law firm of Covington and Burling for his guidance through the FCPA's provisions and to Lynn Saif for her valuable editorial assistance.

The Weisberg/Reichenberg study sets out for the first time a representative collection of opportunities foregone or foreclosed because of the vagaries of the FCPA. The sum of these accounts makes a compelling case for revising the FCPA. The International Division of the U.S. Chamber is pleased to publish this study as part of its Research Reports series in the belief that it makes a valuable contribution to the literature on U.S. trade legislation.

John Volpe
Director of Research
International Division
Chamber of Commerce of the United States

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INTRODUCTION

This report illustrates the uncertainties generated by the vague and ambiguous language in the Foreign Corrupt Practices Act, as well as the related costs to U.S. business. For the past year, the Chamber of Commerce of the United States has been collecting actual examples of the difficulties U.S. companies have experienced as a consequence of the Act. Those accounts[1] are synthesized in an effort to highlight those areas of the law in need of clarification or revision and to demonstrate that the Foreign Corrupt Practices Act has gone beyond the original intent of the Congress.[2]

The Foreign Corrupt Practices Act (FCPA) was enacted in December 1977 in response to revelations of scandals involving payments by U.S. companies to foreign government officials. Congress was determined, and rightfully so, to eliminate corrupt payments to foreign government officials, candidates, and political parties made in order to gain favor and influence in transacting business in overseas markets. However, the experiences of U.S. companies under the FCPA over the past three years clearly reveal unintended confusion in interpreting the law and the ineffectiveness of unilateral legislation for reforming foreign market practices.

The statutory language has proven to be ambiguous and short on standards by which corporate management can measure compliance. The two enforcement agencies involved — the Justice Department and the Securities and Exchange Commission — have not identified their enforcement priorities and have generally avoided providing clear guidance as to the kinds of conduct which are unacceptable under the Act. Congress clearly intended for companies to make adjustments to be in compliance with the FCPA. However, statutory vagueness, together with uncertainty as to enforcement priorities and

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1 Approximately 180 responses were received from U.S. firms, both domestic and foreign-based.

2 The identities of the companies responding to the U.S. Chamber's request for examples of FCPA problems are not disclosed because of the sensitive nature of this legislation and so as not to reveal corporate operations to competitors. This anonymity in no way detracts from the reality or significance of the examples.

stiff criminal penalties, have caused companies to err on the side of excess in making costly adjustments in their business practices and record keeping and to avoid some export transactions altogether.

The costs of the FCPA to U.S. companies take many forms. Legal, administrative, and accounting expenses have increased substantially in response to FCPA requirements for strict overview of U.S. foreign commercial operations. For those companies dealing in overseas markets, the law takes its toll in the number of sales lost to foreign competitors, none of which are subject to FCPA-like constraints. Congress may have been willing to accept lost U.S. sales as the price for high standards of conduct by U.S. businessmen, but it did not intend that sales be lost simply because a U.S. concern was uncertain as to whether specific conduct falls within the prohibitions of the FCPA. Some of the case histories in this report show business foregone under circumstances Congress never intended to reach.

The evidence collected indicates that the FCPA has made U.S. companies wary of engaging in business in some overseas markets and that many foreign countries are equally as reluctant to do business with American companies when the specter of the FCPA is present. There are numerous instances where customers, foreign agents, and joint-venture partners have ended their business relationships with a U.S. concern because they feared becoming implicated in U.S. government charges against that U.S. company. Some of the cases illustrate the concern over the extent to which a U.S. company is responsible for the actions of third parties over which it has little or no control, such as foreign agents, minority-owned subsidiaries, and joint-venture partners.

U.S. companies have also lost overseas business because they would not engage in customary local business procedures which they felt might be questionable under the FCPA. A representative list of those practices included in this report shows that most of these are not within Congress's intended proscription. Many such practices are legal, required by convention, or are considered common courtesy in foreign countries, and failure to conform can make business impossible. The overall effect of the FCPA has been to cause U.S. companies to limit much of their activity to geographic regions where there is relatively little risk of running afoul of the FCPA. Consequently, U.S. firms are much less likely to enter the world's fastest growing export markets, because the FCPA has greatly added to the risk of doing business in developing countries.

U.S. companies alone have borne the costs of the FCPA. A unilateral moral stand on the subject of corrupt payments has not and will not reform foreign attitudes. Although there has been little success to date in devising an international antibribery agreement, the consensus among U.S. businesses is that such an

agreement must be pursued. In the interim, the Foreign Corrupt Practices Act should be clarified, so as not to unnecessarily burden U.S. business. If there is to be a prohibition against certain conduct, that prohibition should be unambiguous, both in intent and language, and reasonably limited to legitimate U.S. enforcement interests.

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THE FOREIGN CORRUPT PRACTICES ACT

Inception of the FCPA

In the course of its Watergate investigations of illegal domestic political payments, the Securities and Exchange Commission (SEC) learned that secret funds were used to conceal many legally questionable corporate payments to foreign government officials and political parties. Subsequently, the SEC set up a disclosure system which invited companies under its jurisdiction to report all of their questionable and illegal payments and accounting practices regardless of their materiality. In early 1976, the Senate Committee on Banking, Housing and Urban Affairs held hearings on the matter of questionable payments to foreign government officials by U.S. corporations. In May 1976, the SEC issued its "Report of Questionable and Illegal Corporate Payments and Practices" which recommended that legislation be enacted that would enhance the accuracy of corporate books and records and strengthen corporate systems of internal accounting control.

On September 15, 1976, the Senate unanimously passed S.3664, which incorporated the SEC's recommendations and a direct prohibition against the payment of bribes to political entities in foreign countries by U.S. companies or related personnel. The final House and Senate approved bill was signed by President Carter on December 19, 1977.

Laws for controlling aspects of transactions involving corporate payments to foreign officials, such as the wire and mail fraud statutes, were on the books prior to the enactment of the FCPA. One of the broadest of these was section 1001 of the Fraud and False Statements Act, which reads:

> Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willingly falsifies, conceals, or covers up by trick, scheme, or devise a material fact, or makes any false, fictitious, or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false,

> fictitious or fraudulent statement of entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

Other areas where there are laws or regulations relevant to foreign payments include:

1. International Security Assistance and Arms Export Control Act of 1976, requiring reports filed with the Secretary of State of political contributions, gifts, commissions, and fees paid to agents in sales of military equipment;

2. Military Sales Act of 1968, requiring disclosure to the Department of Defense of all fees and commissions paid in the sale of military equipment;

3. Export-Import Bank loans, requiring declaration of commissions and fees paid; and

4. Agency for International Development loans to foreign countries for purchasing U.S. products, requiring a statement that no kickbacks or commissions were paid.

The Act

The Foreign Corrupt Practices Act addresses two areas of concern — record keeping and internal accounting controls (section 102) and payments to foreign government officials (sections 103 and 104). Section 102 of the FCPA, which amends section 13(b) of the Securities Exchange Act of 1934, contains the accounting standards which are intended to strengthen the accuracy of corporate books and records and the reliability of the audit process. Subparagraph (b)(2)(A) requires SEC-reporting companies to "maintain books and records that accurately and fairly reflect the transactions and dispositions of the assets of the issuers." Subparagraph (b)(2)(B) requires issuers to devise and maintain internal accounting controls sufficient to provide "reasonable assurance" that:

1. transactions are executed in accordance with management's general or specific authorization;

2. transactions are recorded as necessary (a) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria

applicable to such statements and (b) to maintain accountability for assets;

3. access to assets is permitted only in accordance with management's general or specific authorization; and

4. the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Sections 103 and 104 provide criminal penalties for making payments to a foreign government official, foreign political party official, or political party, or a candidate for foreign political office for the purpose of influencing the recipient to enable the payor to obtain or retain business. Section 103 applies to firms under the jurisdiction of the SEC, and section 104 applies to all other domestic concerns. Facilitating payments, or so-called "grease payments," made in order to expedite matters handled by ministerial or clerical staff are exempted from prosecution. Sections 103 and 104 are applicable irrespective of who initiated the possibility of a payment, although the legislative history does provide that corporate payments made in response to threats of harm or damage would not be considered bribes.

The bribery provisions apply not only to companies, but also to representatives of a company, such as officers, directors, employees, or stockholders, making overseas bribes on behalf of the corporation. The prohibitions against corrupt payments also apply to payments by agents where the corporation knows or has reason to know that a payment will be passed on in whole or in part to a foreign official for a proscribed purpose.

The SEC is responsible for enforcement of the accounting provisions. Jurisdiction over the bribery provisions is divided — the SEC having civil authority over the firms reporting to it and the Justice Department having civil jurisdiction over nonreporting companies, as well as all criminal enforcement authority. When the SEC believes it has compiled sufficient evidence to bring a criminal action against a reporting company for violations of either the accounting or antibribery provisions, it refers the case to the Justice Department for criminal prosecution.

The penalties for violation of section 102, the accounting provisions, consist of fines against the convicted person of up to $10,000 or five years imprisonment, or both. The penalties for violation of sections 103 and 104 are quite severe. A company can be fined up to and including one million dollars. An officer, director, employee, or stockholder acting on behalf of a company can be fined not more than $10,000 or be imprisoned not more than five years, or both. Whenever a fine is imposed on any officer, director, stockholder, employee, or agent of an issuer or domestic concern, the fine cannot be paid, directly or indirectly, by the company.

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STATUTORY AMBIGUITIES

The Foreign Corrupt Practices Act contains language which is ambiguous and confusing, not only to businessmen, but to lawyers and accountants as well. Neither the legislative history nor policy statements by the SEC and Justice Department has provided adequate guidance for proper conduct under the Act. The record keeping and internal control provisions use excessively vague language in setting the accounting standards reporting companies must maintain. The antibribery provisions of the Act are, perhaps, even more unclear and do not take into consideration the variations in business practices from country to country.

The Accounting Provisions

Section 102 of the Act, which applies to companies even when there is no overseas business involved, requires companies subject to the jurisdiction of the SEC to maintain strict accounting standards and management control over their assets. However, the record keeping and internal control provisions do not make clear the standards for compliance. Normal accounting practices based on the accounting concept of "materiality" are not acceptable under the FCPA. The statutory vagueness is particularly critical given the severity of the accompanying civil and criminal penalties.

A company can be prosecuted because an internal control system is not deemed to provide "reasonable assurances" that a proper level of accountability for assets is maintained. The fact that the Senate Banking Committee's report[3] on the FCPA refers to generally accepted

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[3] U.S. Congress, Senate Committee on Banking, Housing and Urban Affairs, Senate Report No. 95-114, p. 8.

accounting principles in explaining what is meant by standards of reasonableness does not relieve the vague nature of the "reasonable assurances" concept because it is not a term to be found within genetally accepted accounting principles.

There are no standards in the Act on which to base what is a demonstration of reasonableness, and the legislative history provides little in the way of guidance. The Senate Committee report on the FCPA states:

> While management should observe every reasonable prudence in satisfying the objectives called for in paragraph (2) of section 13(b), the Committee recognizes that management must necessarily estimate and evaluate the cost/benefit relationships of the steps to be taken in fulfillment of its responsibilities under the paragraph. The accounting profession will be expected to use its professional judgement in evaluating the systems maintained by issuers.[4]

A cost/benefit analysis of internal control methods by a company may vary considerably from that of a federal enforcement agency. What appears to be a congressional effort to provide guidance fails because it lacks objective standards. Furthermore, it is unclear whether one error in judgement with respect to record keeping renders the internal control process unreasonable under the terms of the FCPA.

There is also no guidance for determining what is intended by "reasonable detail" of financial records or by "accurately and fairly" reflecting transactions or asset dispositions. The concept of "in reasonable detail" was inserted in response to criticism that without it the law would require an unattainable degree of exactitude. Inclusion of this language, however, still leaves uncertain the degree of exactitude required. What might be reasonable for one company may be unreasonable for another.

The accounting provisions place excessive responsibility on the accounting profession. Although the objectives contained in subsection 2(b) of the accounting provisions[5] are taken directly from authoritative accounting literature, the statutory language lacks

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[4] Ibid.

[5] See Appendix A.

precision. As the American Bar Association has put it, "Language which may be appropriate and adequate to serve as guidelines for accountants is not necessarily appropriate for inclusion in a statute, the violation of which carries civil and criminal penalties."[6] The FCPA has turned the accounting profession into interpreters of the law, a role ill-suited to the profession. Although the accounting profession and the SEC have provided some guidance to companies on how to comply with the accounting provisions, much uncertainty remains due to the excessive subjectivity of those provisions.

In general, corporate management has reacted unfavorably to the accounting provisions of the FCPA as an uncalled for intrusion into the internal affairs of corporate management. The SEC has been given an open door into corporate management policy through its prerogative to judge what is "reasonable," "accurate," and "fair" in corporate accounting practices, which translates into the power to rule on management technique.

Because of the severity of the penalties under the FCPA, companies and accountants tend to overcompensate in their internal control systems rather than risk zealous interpretation and prosecution by the SEC. The immediate effect of the accounting section of the Act has been to increase the administrative costs of internal accounting controls. The legislated requirement of an "adequate" system of internal controls is so broad that it may be compared to revising the criminal code to "citizens must behave themselves." In his January 13, 1981 speech, former SEC Chairman Williams recognized that the anxieties created by the Act due to the possibility of criminal liability for corporate officials have led businesses to develop overly burdensome compliance systems which extend beyond what is needed for sound management or what is intended by the Act.[7]

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[6] Federal Regulation of Securities Committee, American Bar Association, cited in Internal Control in U.S. Corporations: The State of the Act, Financial Executive Research Foundation, 1980, p. 415.

[7] Securities and Exchange Commission, Release No. 17500, January 29, 1981, Vol. 21, No. 18, February 10, 1981, docket 1467.

The Bribery Provisions

In the bribery provisions of the Act, the following ambiguous terms and phrases have injected uncertainty into overseas business transactions:

1. Companies are generally unclear about the kinds of actions or communications which would produce a "reason to know" that there might be a questionable payment.

2. The term "foreign official" as defined in the FCPA, which includes any officer or employee of any agency or instrumentality of a foreign government, leaves uncertain the status of employees of government-owned enterprises.

3. There are no standards for determining when duties are "esentially ministerial or clerical."

4. "Gifts" or "anything of value" are terms subject to a broad range of interpretation. The line between business courtesies, legitimate market expenses, and attempts to influence can be a fine one and will vary from country to country.

5. Although the statute does not prohibit so-called "grease" or facilitating payments, the demarcation between permissible "grease" payments and illegal corporate bribes can be extremely subjective and a function of the varying environments in which the firm is operating.

Aside from the vagaries of specific terms and phrases, there are broad areas of uncertainty generated by the FCPA. For example, there is considerable lack of clarity as to the responsibility for the acts of third parties of a U.S. firm operating abroad in conjunction or association with foreigners, particularly in operations over which U.S. firms have very little control, e.g., minority-owned joint ventures or minority-owned subsidiaries. The uncertainty as to when U.S. firms are liable for the acts of a foreign subsidiary is compounded by the fact that a U.S. parent which claims lack of knowledge of corrupt payments made by its foreign subsidiary can be prosecuted for failing to establish an adequate internal control system. Although the January 13, 1981 speech by SEC Chairman Williams somewhat clarified the SEC position on parent company responsibility for the activities of its foreign subsidiaries, much remains to be explained.[8]

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[8] See SEC Release No. 17500, docket 1471.

II

In many countries it is essential to employ local agents as sales representatives for foreign products. Yet, U.S. companies are unsure as to the extent of their responsibility for the actions of agents and dealers over whom the company realistically has little direct control. There is no indication in the law or the legislative history as to what might be considered a reasonable agency fee nor as to what degree of supervision a U.S. firm must exercise over an agent.

Enforcement Policies

One of the most troublesome aspects of the FCPA to businessmen is the lack of clear enforcement priorities by the SEC and the Justice Department. This is further complicated by the concurrent jurisdiction over section 103, where a company may be subject to inconsistent interpretations of the law by the SEC and the Justice Department.

At a PLI seminar in Chicago,[9] there were instances of disagreement between representatives of the SEC and Justice Department on the interpretation of the FCPA. If members of the enforcement agencies disagree among themselves as to the liability of firms involved in questionable situations, it is likely that enforcement of the law is subject to too much administrative discretion. How is corporate management to distinguish between what is proper and what is not if neither SEC nor Justice Department officials can agree?

In instances where the SEC and Justice Department agree on enforcement policy standards, their interpretations tend to be excessively broad. Unofficial remarks by representatives of the SEC and the Justice Department indicate that their interpretation of permissible grease payments does not conform to the legislative history of the FCPA. They would likely take a narrow view of what qualifies as a facilitating payment and would find that regularity in "grease" payments creates a presumption of an intention to circumvent the FCPA. Yet, the legislative history makes it clear that Congress did not intend to limit multiple expediting payments so long as the individual transactions pass muster. As a result of broad interpretation of the "know or reason to know" clause, there is a possibility

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9 Practicing Law Institute Seminar - March 22 - 23, 1979, Foreign Corrupt Practices Act Reporter, Business Laws, Inc., 1980, pp. 109-130.

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The Business Costs of Uncertainty

Over three years of business experience under the FCPA have underscored the uncertainty and confusion deriving from the ambiguous language of the Act and the lack of clear statements of enforcement priorities by the SEC and the Justice Department. During three years, little has evolved in the way of guiding precedent on what practices and circumstances are likely to expose business to prosecution under the FCPA.

As with any business risk, the uncertainty surrounding the FCPA has real, although not easily quantifiable, costs. These costs include the allocation of resources to assure compliance with the FCPA, lost business resulting from the anticompetitive nature of the Act, the alteration of business practices in order to guarantee compliance, and, finally, the avoidance of business opportunities in order to eliminate completely any FCPA risk. The cost of legal advice to safely steer a company through the provisions of the FCPA can be quite steep and even prohibitive, particularly for small businesses. One must realize that a charge of misconduct carries with it a cost of defense, even if there is no actual illegal conduct. Therefore, in order to avoid inadvertent violations, or the appearance of questionable conduct, companies have subjected themselves and their foreign marketing representatives to costly, time-consuming, and burdensome procedures. These costs will be demonstrated by actual business experiences in the discussion which follows.

Foreign Reaction: The Unwillingness to do Business

The FCPA has generated considerable ill feeling on the part of foreign agents, companies, and governments, some of whom are reluctant to engage in business with companies whose government might accuse them of being corrupt. As one Thai businessman put it: "We have been a nation for 1,000 years and a culture for 3,000 and resent the United States telling us that our business practices are immoral." Foreign businessmen find it difficult to understand why a company should be charged with misconduct by the U.S. government when there is no similar allegation at the place of the act.

Foreign marketing representatives and agents are reluctant to deal with U.S. companies because of the demands placed on them by the FCPA. The record-keeping provisions of the FCPA require U.S. companies to extract information from their foreign agents as to the disbursal of their fees. The agents often object to having their business dealings scrutinized by the U.S. government. This has resulted in the loss of services from well-established agents -- a cost that can make business difficult, if not impossible, especially in Middle Eastern and Asian markets.

A host country's hostility toward the FCPA can result in a lack of cooperation in the enforcement of the FCPA. Unfortunately, this tends to work to the detriment of the accused U.S. business concern. In a situation in which a U.S. company is being prosecuted for possible FCPA violations in a foreign country, it is nearly impossible for the company to build a viable case for its defense. The U.S. company will unlikely be able to get foreign business associates and clients to submit evidence, because there might be the possibility of their becoming involved in domestic legal problems or having their public image tarnished by adverse publicity. Furthermore, it is difficult, if not impossible, for a U.S. firm to know all the third party business arrangements that a business associate or client might be involved in and which might lead to charges of violation of the FCPA under the "know or reason to know" clause.

It is chauvinistic for the U.S. enforcement agencies to impose management requirements on U.S. businesses abroad which demand certain standards of business conduct from foreign nationals. Former Chairman of the SEC, Ray Garrett, indicated the impracticality of U.S. unilateral standards for companies operating abroad when he said that he did not believe that the Commission had a mandate "to enforce, even indirectly, through compulsory disclosure, all of the world's laws and all of its perceptions of morality and right conduct."[10]

The following are examples of the reaction by foreign governments, customers, and agents to the FCPA and consequent lost opportunities for U.S. business:

1. There are more than 800 U.S. subsidiaries doing business in Australia which, excluding minerals,

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[10] Neil H. Jacoby, Peter Nehmkis, Richard Eells, Bribery and Extortion in World Business, 1979, p. 63.

account for more than one quarter of Australia's exports. There is growing concern on the part of the Australian government and domestic industry that the FCPA may be costing the country export income because of reluctance on the part of U.S.-controlled companies to become involved in commercial arrangements that may raise questions under the FCPA.

2. An American company held 20 percent equity in a company in Country E in Southeast Asia. As part of their agreement, the American company provided technical and managerial expertise and held one seat on a five-man board in return for a fixed fee and a percent of the profit. Under a consent agreement reached with the U.S. government, the manager of the American company was required to sign quarterly statements of FCPA compliance. When he informed the Country E board of this requirement, they suggested the following alternatives:

   (a) replace the American manager with another national who would not be required to sign the compliance statement; or

   (b) divest their interest in the Country E company.

   Since the American company knew that the change of manager would not release them from the FCPA compliance agreement, they were forced into the divestment alternative. Unfortunately, the timing was poor and the sale of equity was at half the asset value. The loss for 1979 on the investment, management fees, and profit sharing were estimated at $2 million.

3. An American electrical equipment distributor had been doing business in Country C, a Southeast Asian country, since the turn of the century. Their local manager, an American, was born there, spoke the language, and was married to a Country C national. The electrical equipment sold by the company was mainly purchased by the state

railway's procurement office. The procurement office's manager was a close personal friend of the American manager. No money had ever changed hands between these two as part of a business transaction. Country C's railway procurement officer had close personal and professional ties with his counterpart in neighboring Country D. During an SEC investigation, the Country D procurement office manager's name was mentioned. As a result, the Country C manager abruptly broke off both personal and business relations with the American manager of the electrical equipment supplier.

Months later, through an intermediary, the American manager received two messages from his old Country C friend which said:

(a) that he feared similar, but unfounded accusations; and

(b) that an Asian competitor had offered him five percent payable outside his country for any purchases he approved for their product.

4. An American manufacturing company exported its products to Country A in Southeast Asia where they were marketed by a local agent. The relationship had existed for over ten years. Although the commission paid to the agent was reasonable, the manufacturer suspected that the agent may have used part of the commission to pay government procurement officials. His suspicions were based mainly on his knowledge of local trading practices, although there was no way he could verify these concerns.

Shortly after the passage of the FCPA, the agent abruptly cancelled his agreement with the manufacturer. It was determined later that the agent had signed an agreement with a European competitor. Two months later the manufacturer lost a tender, on which he directly bid, to his old agent, even though his bid was competitive. After an unsuccessful attempt to find a new agent, the manufacturer withdrew from the market in 1979.

5. A foreign contract was awarded to a European consortium for an amount 333 percent greater than the U.S. company's preliminary bid. No reason was given for the failure of the U.S. firm to be considered for the final bidding. The U.S. company believes that the prospective customer did not want to deal with a company subject to the FCPA.

6. American Company, XYZ, sold its high value products to the Air Force of Country Purple for about $20 million. This sale was a direct manufacturer-to-user sale made without the intervention, in the formal sense, of an agent or distributor. The arrangements for the sale were made by XYZ's employee resident in Purple. Mr. A had introduced that representative to several important Air Force officers, which may or may not have lead to the eventual sale. Mr. A claimed a commission on the sale, but XYZ refused.

   In 1979, Mr. A sued XYZ in the courts of Purple. When it became obvious that Mr. A had no case and was about to lose, he attempted to force a settlement by threatening that if XYZ did not pay him, he would report to the U.S. Department of Justice and the SEC that XYZ had paid bribes to Purple's Air Force officials to get the order. Mr. A knew that the allegation was completely false, but he also realized that XYZ could not afford to have its reputation soiled nor to go through the time and expense of investigations to disprove the false allegation. Even if XYZ were cleared of any FCPA wrongdoing, it still might lose future business in Purple because the Air Force would be reluctant to deal with them for fear that they might be slandered by false claims. XYZ decided to pay the extorted settlement rather than face the alternatives.

Confusion Over What Constitutes A Facilitating Payment

A "grease" payment is made to facilitate or expedite a business-related activity that a government employee is already required to do. Such payments are customary in many markets for such government personnel as customs officials and issuers of licenses. A

typical example is $20 given to a customs official so that he will move the necessary papers before the banana shipment on the docks rots. In the United States, this kind of practice is clearly illegal. Congress, however, recognized the necessity of facilitating payments in many foreign markets and exempted them from the prohibitions of the FCPA.

Rather than specifically stating that the FCPA does not apply to customary facilitating payments, the exemption is reached in a roundabout way by defining a foreign official to not include any employee "whose duties are essentially ministerial or clerical." This has injected additional subjective evaluations into the determination of what is and is not an acceptable expediting payment. The situation is aggravated by varying interpretations by the enforcement agencies as to the parameters of the exemption. For example, some in the Justice Department maintain that a repeated history of grease payments is in and of itself questionable.

Confusion over the FCPA provisions on and the Justice Department's interpretation of the facilitating payments exemption has caused many U.S. companies to refrain from making customary grease payments. The following is a list of payments that some companies have stopped as a consequence of FCPA ambiguity:

(a) payments to customs officials to expedite approval of import and export papers;

(b) payments to immigration officials to perform their normal duty in granting a visa to remain in a country;

(c) payments to expedite the return of funds previously paid to the government as a bond for customs purposes (there is a guaranteed right of refund, but delays of more than two years can be normal in some countries); and

(d) providing gasoline to policemen in order to permit them to patrol company facilities more frequently (In many developing countries, police budgets are limited, so they depend on nongovernmental income to improve their effectiveness.).

What follows are cases where a company, unsure of the scope of the facilitating payments exception, stopped making certain payments and, consequently, experienced business losses:

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1. American company, GHI, with a manufacturing plant in country Blue needed some spare parts for a machine which broke down and were not available in Blue. A new employee, travelling from the head office in the United States with his wife and six-month old baby to Blue, brought the needed parts with him. He arrived in Blue exhausted after a 24-hour airplane ride. He openly declared the spare parts to the Blue customs authorities at the airport. The authorities then began to dicker over the amount of the duties due and the supposed failure to have the proper import documentation, inferring that a tip should be made. This was politely ignored. Two hours later, the customs duties paid, the authorities then refused to allow the item to be taken from the airport into the country without some further formalities which would take several days. In exasperation, the local Blue director of GHI, who had come to welcome the new man, paid out of his own pocket the equivalent of $20 to the customs officials (the standard payment expected) and was immediately allowed to leave with the parts and the newly-arrived personnel.

   Having made what he considered a normal business payment in Blue, the director submitted a voucher to GHI for reimbursement. The comptroller of GHI refused to pay because to do so would be contrary to the company's FCPA compliance policies. As a matter of principal, the local Blue director threatened to resign. The American managing director finally settled the dispute by approving the payment. The item, however, did not pass the internal auditor from the head office. The American managing director's career is now on the line, and the parent company has spent over $30,000 internally investigating why the $20 bribe was paid and how to cope with it under the FCPA and related SEC regulations.

2. An American company, DEF, had an agricultural resources concession in country White for over 50 years. This concession had to be reviewed periodically, the renewal fees being nominal and the renewals being routine and almost automatic, barring political upheavals. The concession had to be renewed in 1979. It required about 20 to 30 signatures of local, district, provincial, regional, and, finally, national officials to obtain the renewal. The normal practice had been to pay a small

amount for each signature. Payments varied in form, e.g., a new shirt, repair of one official's jeep because the government had no funds to do so, a donation toward an official's son's wedding, payment of school fees, a bottle of perfume for female officials, food packages, a new airconditioner for an official's office or home, etc. As a consequence of FCPA concern, DEF had strict orders from the head office to make no further payments and to bestow no gifts.

As a result, the concession has expired and the renewal papers are still stalled. DEF lives under the constant threat of criminal sanctions for proceeding to work under the expired concession.

3. A U.S. company transferred an executive to its subsidiary in a South American country. The customs duty on the executive's household shipment was declared to be 3.5 million monetary units. However, it was made clear by customs officials that an "under-the-table" payment of one million monetary units would reduce the duty assessment to one-half million monetary units. It appears that the initial assessment was set particularly high in order to "encourage" a payment to the customs officials. In order to avoid any problems under the FCPA, the company paid the full assessment, at a lost savings of two million monetary units.

4. During an exhibition trip to Singapore, a U.S. company learned that a series of payments would be required in order to do business in Indonesia. These included payments to the switchboard operator in the hotel, to secretaries for arranging appointments, to the administrative assistant of the customer to meet with the customer (although an appointment had already been made) to all the company sales representatives, to guards watching unloaded merchandise, and to customs officials. Unclear as to which payments were proscribed by the FCPA, the company withdrew from competition for installation of communications equipment.

Reluctance to Adapt to Foreign Customary Practices

In many foreign countries, especially the developing nations, gifts, entertainment, travel, and other social accommodations have historically been a part of developing and maintaining friendly relations between the business community and government. Gift-giving is a time-honored social custom and a part of business protocol in many countries. Such social gestures are not only permitted under local laws, but are a required first step before the specifics of a business transaction can be taken up. In most foreign countries, the suggestion that the receipt of entertainment or a gift would influence a government official to act improperly would be insulting. Because the FCPA carries with it the suggestion of impropriety for these business amenities, it inhibits U.S. companies from creating the proper environment for doing business in many foreign countries.

The FCPA, in effect, segregates the world into countries which are suitable for U.S. companies to conduct business in and those which are not suitable. No other nation has antibribery prohibitions similar to the FCPA. The FCPA legislates that American companies must conduct their business in other countries as they do in the United States. This simplistic approach is unworkable because moral values are not consistent throughout the world.

The following payments were stopped by certain U.S. companies because there was concern that they might be in violation of the FCPA:

(a) expenses incurred by a government purchasing officer for expenses incurred for a trip to review qualifications, specifications, delivery, schedules, etc.;

(b) payments for expenses incurred when a government official must leave his home area to fulfill his duties (Although local laws do not authorize such payments, government officials are aware of them and orally endorse them; however, they will not request such payments in writing, since such a step would be going beyond their authority.);

(c) writing specifications for equipment for the government without charge, in the hope of obtaining future business;

(d) payments for expenses incurred by a government employee while attending a company training

course (the same expenses as for regular employees);

(e) payment of a yearly gratuity to the local postmen;

(f) payment of a finder's fee to an agent even though it is for government business; and

(g) a wedding gift to the daughter of a government official.

The following examples demonstrate the consequences of failure to follow customary business practices in foreign markets:

1. To secure business with a military entity in a country, it was customary for a U.S. company to place an advertisement in the customer's internal publication at an admittedly inflated price. After passing of the FCPA, the U.S. supplier was no longer willing to accommodate this practice, the result being a loss in sales to the military entity.

2. A group of customers, including officials from two government-run factories, wanted to visit a U.S. supplier for technical orientation. The supplier, unlike in past years and unlike its European competitors, refused to pay the expenses of the group. Because the group included wives of some of the company presidents, the U.S. supplier was afraid that picking up the tab for expenses would be in violation of the FCPA. Consequently, the U.S. corporation lost the contract for supplies to a European competitor unencumbered by such legal uncertainty.

3. In Asia, it has always been customary and, in fact, required to provide samples of new drugs to doctors and hospitals. Health care in this part of the world is often provided in government facilities. It is well known that the samples are sold to provide extra income for government hospital doctors and staff. Those firms that "sample generously" are more likely to have their products prescribed. Now, due to the FCPA, pharmaceutical companies are unsure as to how much sampling would constitute a violation. There

is a question as to whether samples provided to doctors and purchasing agents that ultimately are given to government doctors and hospitals can be considered corrupt payments. The alternative is that less sampling results in Japanese, German, and Swiss competitors taking away the business of the U.S. pharmaceutical companies because they have no restrictions on their sampling practices.

4. In Thailand, it is normal practice to "assist" government personnel by providing specifications for items to be procured through bidding. This assistance can include cash payments, gifts, free travel, etc. A U.S. office equipment company, concerned about potential FCPA violations, refused to "assist" potential customers. In one instance of lost business, the U.S. firm obtained the bid documents. Had the company supplied the "assistance," its bid would still have been 15 to 10 percent lower than the Japanese firm which won the contract.

5. A U.S. company had been considering setting up wholly-owned marketing companies in countries such as the Phillipines, Indonesia, Thailand, South Korea, and Taiwan to replace local sales agents in those countries. These plans were deferred indefinitely because of excessive expenses for ensuring compliance with the FCPA in light of local customary business practices which are not up to the standards required by U.S. law.

Difficulty of Controlling Third Parties

The "knowing or having reason to know" language in the FCPA has probably created more uncertainty for U.S. concerns than any other part of the Act. Neither the Act nor the legislative history provide an indication as to what procedures a company must go through to be sure that it does not have "reason to know" that an agent over whom it has little control engages in corrupt political payments.

Because a U.S. company may be criminally liable for its agents' conduct, some companies avoid local agents altogether. Where local agents are the normal vehicles for commercial transactions, sales will be lost to those countries willing to employ them.

The problems of control extend to local subcontractors and foreign partnerships and joint ventures, as well as any other business relationship where at least one party is not directly subject to U.S. jurisdiction. If a foreign firm engages in questionable conduct without informing its U.S. partner, the U.S. company may still be liable under the FCPA. The following examples show business foregone when a company could not be sure of third-party compliance with the FCPA:

1. A major U.S. corporation refused sales valued at several hundred thousand dollars to a Middle East quasi-government organization because it would have been required to pay commissions to a private company in order to collect its account. The U.S. corporation could not be certain that part of the payments would not be passed on to some government officials.

2. A major U.S. corporation declined a substantial subcontract in an African country because of the possibility of an indirect payment to government officials in that country through the prime contractor. The subcontract was subsequently awarded to a European competitor unencumbered by a statute like the FCPA.

3. A multinational U.S.-based engineering company spent approximately a quarter million dollars on a 1979 study to evaluate its potential market in Latin America. Three countries — Brazil, Mexico, and Venezuela — were seriously considered as potential markets for either exporting process engineering services or establishing local engineering services. One of the major reasons the company chose not to pursue these markets was that business practices associated with the construction industry in these countries are significantly different than those in the more developed markets in which the company currently operates. Although the company is opposed to the concept of improper payments and, in fact, specifically prohibits these as part of its corporate policy, it felt that

the unrealistic provisions of the FCPA regarding responsibility for the activities of independent agents and subcontractors and the concomitant costs to try to police such activities would have markedly lessened its competitiveness in this market.

4. A company initiated a procedure of reading a position paper stating its policy of compliance with the FCPA to potential agents and business associates in foreign countries. Since passage of the Act and the commencement of this company policy, the company has not received a single contract involving people to whom the position paper was read.

5. A U.S. manufacturer of major process equipment submitted a bid to supply and install a complete plant for a government-owned company in a Latin American country. During the final stages of the bid process, the customer on several occasions suggested that the U.S. company might be using the wrong local installation contractor and that the customer preferred that the company hire another specific local contractor. Since the U.S. company had a preexisting agreement with a contractor, it felt obligated not to consider a change. Subsequently, the first contractor, which had been aware of the customer's request, offered to release the U.S. supplier from its contractual obligation. The U.S. company, however, declined to change contractors because it might be somehow inadvertently violating the FCPA by favoring one contractor over another at the request of the government-owned customer. At no time did the customer request any sort of payment from the U.S. company.

   The order was finally lost to a German supplier which had employed the recommended contractor. The U.S. company later received a copy of the successful German bid package. An after-action evaluation revealed that, although the technology and services offered by both companies were quite similar, the successful bid had been 15 percent higher than the losing one.

> Clearly, the U.S. company had no reason to believe during the bid process that any improper payment would be made; in fact, there is no evidence that improper payments were made by the successful bidder. The U.S. company feels that because of its FCPA-derived reluctance to change suppliers, it lost a sale in excess of $10 million.

The Costs of Compliance

Accounting Costs

Because the incidence of questionable political payments around the world continues at a constant level, it is clear that all of the costs associated with the FCPA fall on U.S. businesses. To assure compliance with the Act, U.S. companies have had to substantially strengthen corporate codes of conduct and systems of internal accounting control. The adjustments have proven to be unjustifiably burdensome because the Act's ambiguities have forced companies to overcompensate in their adjustments. Fifty-five percent of the respondents to the recent GAO survey[11] on the FCPA reported that their efforts to comply with the Act have resulted in costs that were greater than the benefits.

Half of the GAO survey respondents believed that the FCPA increased their accounting and auditing costs by 11 to 35 percent, primarily through increased documentation and larger internal audit staffs. The GAO concludes that the fear of criminal sanctions for accounting errors and control weaknesses that are not related to improper payments is one reason that companies incur unnecessary compliance costs. As an example, one U.S. multinational, not considered to be a major exporter, estimated that on an ongoing basis the FCPA accounting provisions generate an additional cost of approximately $425,000 per year. In addition, the firm incurred a one-time $250,000 cost to evaluate its internal accounting systems worldwide. These costs are the result of the company's efforts to achieve a "zero defects" internal accounting control system. When projected across the full range of U.S. businesses, this example raises the question as to whether the costs to U.S. investors are warranted.

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[11] Comptroller General of the United States, Impact of the Foreign Corrupt Practices Act on U.S. Business, General Accounting Office of the United States, March 4, 1981, p. 13.

Legal Fees

The FCPA's statutory ambiguity increases the need for legal counseling in overseas transactions. Given the fact that the hourly fee for partners in major law firms exceeds $100, many companies may shy away from even investigating overseas potential once they are made aware of the complexities of the FCPA. The export disincentive nature of this situation for smaller businesses is particularly critical. Finally, the expenses associated with in-house corporate counsel should not be overlooked.

Impact on Exports

The FCPA has left U.S. companies seeking to do business worldwide at a substantial competitive disadvantage. Areas in which the United States is particularly competitive in international markets include the aerospace, communications, and information processing industries. Aside from agriculture, these industries account for the largest share of U.S. exports. However, there is increasing competition in these areas from European and Japanese firms, which have begun to challenge U.S. technological leadership. It is also in these export industries that there is the greatest propensity for firms to be dealing with foreign governments and foreign officials. The FCPA limits the conduct of U.S. firms in these vital export areas, while the Europeans and Japanese are free to comply with the practices of the foreign markets.

In February 1980, a White House task force reported that State Department officials in 15 countries, out of 45 countries surveyed, perceived the Act as having a negative impact on exports. Seven posts perceived the Act as having a significant adverse impact. All 15 of the posts were in less-developed countries, which the Department of Commerce reports are the major growth areas for U.S. exports.[12] One Department of Commerce official said that export increases in countries where the Act has had a negative impact on U.S. exports would have been significantly greater if it were not for the FCPA.[13]

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[12] Ibid., p. 16.

[13] Ibid., p. 16.

Lost Sales

The competitive disadvantage that the FCPA leaves U.S. business with is demonstrated by the GAO survey statistics, which report that 30 percent of the respondents claim lost overseas business as a result of the Act. Sixty percent of the questionnaire respondents believed that, assuming all other conditions to be similar, U.S. companies cannot successfully compete against other companies abroad that are bribing. In a letter to the U.S. Chamber of Commerce, the president of one company wrote: "As you know, we are a relatively middle-sized company, and, as such, the instances where we have been barred from doing business with Middle East companies because of the FCPA are too numerous to list."

The following two examples give a sense of the dollar value of lost sales attributable to the FCPA:

1. A majority American-owned manufacturing company, ABC, in country Green, manufactured products for domestic consumption and for export. Similar products were manufactured by the Japanese and Europeans in Green and in neighboring countries. Burma had a need for the products ABC manufactured. ABC wanted to be placed on the bidders' list in Burma, but ABC refused to make payments to officials in order to be listed. ABC was never listed despite its best efforts and lost $1 million in sales in one year. ABC's prices would have been more competitive than those companies which actually secured the contracts.

2. One company estimates that the FCPA has caused a loss of two to three percent of their total international sales or between $17 and $26 million for 1978 and 1979.

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International Harmonization And Statutory Clarification

For purely economic reasons it is in the interest of all countries to reduce the size and frequency of improper political payments. When government officials are soliciting improper payments, the criteria for the awarding of a contract will be based on the size of the payment and not the quality of the product or service. This results in the purchase of less efficient plants and equipment and for prices higher than would normally be the case. It is no coincidence that a corrupt government bureaucracy generally goes hand-in-hand with slow economic growth in the less-developed countries. Corrupt payments are also a barrier to trade in that they exclude companies either unwilling or unable to engage in such practices, particularly small business. As such, they are a burden on the growth of international trade and investment.

The Need for International Agreement

Congress rightfully recognized at the time of passage of the FCPA that something had to be done to end corporate payments that were leading to major international scandals. The FCPA, however, has proven to be an ineffective and costly solution to a global problem. That Act sharpened the competitive edge of our foreign competitors, while in no way reforming the business practices in other countries. What the Congress should now recognize is that the problem can only be effectively and fairly dealt with at the international level.

Within the United Nations, the Economic and Social Council (ECOSOC) established an Ad Hoc Intergovernmental Working Group to conduct an examination of the problem of corrupt practices, in particular, bribery and international commercial transactions by transnational and other corporations and their intermediaries. A draft international agreement was submitted to ECOSOC in July, 1978. Although there are many disagreements concerning the details of the proposal, there is general accord among the members of the working group on three basic principles which constitute an essential prerequisite to a viable international code of conduct for business practices:

1. each country should have adequate laws criminalizing bribery and extortion;

2. each country should enforce those laws and in all other ways establish standards conducive to the elimination or prevention of corrupt practices in connection with commercial transactions; and

3. each country should promote mutual judicial assistance to other countries to further their efforts to enforce their laws.[14]

The resolution of a United Nations antibribery agreement, which would not be legally binding, has been hindered by unrelated political disagreements. In particular, an agreement has failed to come about due to the demands of the Group of 77 for an accompanying agreement concerning an international code of conduct for transnational corporations, including a prohibition against the payment of royalties and taxes to the "minority regime" in South Africa. The industrialized countries continue to resist many of the proposals of the Group of 77; thus, an international agreement does not appear to be forthcoming in the near future.

Revision of the FCPA

U.S. companies are supportive of reasonable efforts to eliminate bribery and extortion throughout the world, since they would certainly prefer to do business overseas on a purely competitive basis, where performance, reputation, quality of services, and other normal business considerations are the criteria for obtaining business. Until such practices can be eliminated, however, there are costs to be paid by the United States because of the inflexibility of the FCPA. As this report has demonstrated, some of these costs are unnecessary and could be eliminated through a clarification of the Act.

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[14] Klaus A. Sahlgren, Assistant Secretary General and Executive Director of the U.N. Centre on Transnational Corporations, cited in a speech during Seminar on Extortion and Bribery, The United States Council of the International Chamber of Commerce, March 13, 1979, p. 23.

Public Law 95-213
95th Congress

An Act

Dec. 19, 1977
[S. 305]

To amend the Securities Exchange Act of 1934 to make it unlawful for an issuer of securities registered pursuant to section 12 of such Act or an issuer required to file reports pursuant to section 15(d) of such Act to make certain payments to foreign officials and other foreign persons, to require such issuers to maintain accurate records, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Securities Exchange Act of 1934, amendment.

TITLE I—FOREIGN CORRUPT PRACTICES

SHORT TITLE

Foreign Corrupt Practices Act of 1977.
15 USC 78a note.

SEC. 101. This title may be cited as the "Foreign Corrupt Practices Act of 1977".

ACCOUNTING STANDARDS

Assets, transactions and dispositions.
15 USC 78m.

SEC. 102. Section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)) is amended by inserting "(1)" after "(b)" and by adding at the end thereof the following:

"(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall—

15 USC 78l.
Post, p. 1500.

Records, maintenance.

"(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and

Internal accounting controls, establishment.

"(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—

"(i) transactions are executed in accordance with management's general or specific authorization;

"(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

"(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

"(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Exemption directive, issuance and expiration.

"(3)(A) With respect to matters concerning the national security of the United States, no duty or liability under paragraph (2) of this subsection shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters if such act in cooperation with such head of a department or agency was done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each such directive shall, unless renewed in writing, expire one year after the date of issuance.

"(B) Each head of a Federal department or agency of the United States who issues a directive pursuant to this paragraph shall maintain a complete file of all such directives and shall, on October 1 of each year, transmit a summary of matters covered by such directives in force at any time during the previous year to the Permanent Select Committee on Intelligence of the House of Representatives and the Select Committee on Intelligence of the Senate.". File maintenance. Annual summary, transmittal to congressional committees.

FOREIGN CORRUPT PRACTICES BY ISSUERS

SEC. 103. (a) The Securities Exchange Act of 1934 is amended by inserting after section 30 the following new section:

"FOREIGN CORRUPT PRACTICES BY ISSUERS

"SEC. 30A. (a) It shall be unlawful for any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports under section 15(d) of this title, or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to— 15 USC 78dd-1. 15 USC 78l. Post, p. 1500.

"(1) any foreign official for purposes of—

"(A) influencing any act or decision of such foreign official in his official capacity, including a decision to fail to perform his official functions; or

"(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person;

"(2) any foreign political party or official thereof or any candidate for foreign political office for purposes of—

"(A) influencing any act or decision of such party, official, or candidate in its or his official capacity, including a decision to fail to perform its or his official functions; or

"(B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; or

"(3) any person, while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of—

"(A) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, including a decision to fail to perform his or its official functions; or

"(B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence

any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

"Foreign official."

"(b) As used in this section, the term 'foreign official' means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are essentially ministerial or clerical.".

Penalties.

Ante, p. 1495.

(b)(1) Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended by inserting "(other than section 30A)" immediately after "title" the first place it appears.

(2) Section 32 of the Securities Exchange Act of 1934 (15 U.S.C. 78ff) is amended by adding at the end thereof the following new subsection:

"(c)(1) Any issuer which violates section 30A(a) of this title shall, upon conviction, be fined not more than $1,000,000.

"(2) Any officer or director of an issuer, or any stockholder acting on behalf of such issuer, who willfully violates section 30A(a) of this title shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

"(3) Whenever an issuer is found to have violated section 30A(a) of this title, any employee or agent of such issuer who is a United States citizen, national, or resident or is otherwise subject to the jurisdiction of the United States (other than an officer, director, or stockholder of such issuer), and who willfully carried out the act or practice constituting such violation shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

"(4) Whenever a fine is imposed under paragraph (2) or (3) of this subsection upon any officer, director, stockholder, employee, or agent of an issuer, such fine shall not be paid, directly or indirectly, by such issuer.".

FOREIGN CORRUPT PRACTICES BY DOMESTIC CONCERNS

15 USC 78dd-2.

SEC. 104. (a) It shall be unlawful for any domestic concern, other than an issuer which is subject to section 30A of the Securities Exchange Act of 1934, or any officer, director, employee, or agent of such domestic concern or any stockholder thereof acting on behalf of such domestic concern, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to—

(1) any foreign official for purposes of—

(A) influencing any act or decision of such foreign official in his official capacity, including a decision to fail to perform his official functions; or

(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person;

(2) any foreign political party or official thereof or any candidate for foreign political office for purposes of—

(A) influencing any act or decision of such party, official, or candidate in its or his official capacity, including a decision to fail to perform its or his official functions; or

(B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person; or

(3) any person, while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of—

(A) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, including a decision to fail to perform his or its official functions; or

(B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person.

Penalties.

(b)(1)(A) Except as provided in subparagraph (B), any domestic concern which violates subsection (a) shall, upon conviction, be fined not more than $1,000,000.

(B) Any individual who is a domestic concern and who willfully violates subsection (a) shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

(2) Any officer or director of a domestic concern, or stockholder acting on behalf of such domestic concern, who willfully violates subsection (a) shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

(3) Whenever a domestic concern is found to have violated subsection (a) of this section, any employee or agent of such domestic concern who is a United States citizen, national, or resident or is otherwise subject to the jurisdiction of the United States (other than an officer, director, or stockholder acting on behalf of such domestic concern), and who willfully carried out the act or practice constituting such violation shall, upon conviction, be fined not more than $10,000, or imprisoned not more than five years, or both.

(4) Whenever a fine is imposed under paragraph (2) or (3) of this subsection upon any officer, director, stockholder, employee, or agent of a domestic concern, such fine shall not be paid, directly or indirectly, by such domestic concern.

Civil action.

(c) Whenever it appears to the Attorney General that any domestic concern, or officer, director, employee, agent, or stockholder thereof, is engaged, or is about to engage, in any act or practice constituting a violation of subsection (a) of this section, the Attorney General may, in his discretion, bring a civil action in an appropriate district court of the United States to enjoin such act or practice, and upon a proper showing a permanent or temporary injunction or a temporary restraining order shall be granted without bond.

Definitions.

(d) As used in this section:

(1) The term "domestic concern" means (A) any individual who is a citizen, national, or resident of the United States; or (B) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States.

(2) The term "foreign official" means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are essentially ministerial or clerical.

(3) The term "interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State or between any State and any place or ship outside thereof. Such term includes the intrastate use of (A) a telephone or other interstate means of communication, or (B) any other interstate instrumentality.

TITLE II—DISCLOSURE

Domestic and Foreign Investment Improved Disclosure Act of 1977.
15 USC 78a note.

SEC. 201. This title may be cited as the "Domestic and Foreign Investment Improved Disclosure Act of 1977".

Equity security acquisition, statement, filing. Contents.

SEC. 202. Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended to read as follows:

"(d)(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations, prescribe as necessary or appropriate in the public interest or for the protection of investors—

15 USC 78l.
15 USC 80a-51.

"(A) the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;

"(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public;

"(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

"(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate; and

"(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.".

Equity security ownership, statement, filing.

SEC. 203. Section 13 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78m), is amended by adding at the end thereof the following new subsection:

"(g)(1) Any person who is directly or indirectly the beneficial owner of more than 5 per centum of any security of a class described in subsection (d)(1) of this section shall send to the issuer of the security and shall file with the Commission a statement setting forth, in such form and at such time as the Commission may, by rule, prescribe—

"(A) such person's identity, residence, and citizenship; and

"(B) the number and description of the shares in which such person has an interest and the nature of such interest.

Amendments.

"(2) If any material change occurs in the facts set forth in the statement sent to the issuer and filed with the Commission, an amendment shall be transmitted to the issuer and shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"Person."

"(3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for the purposes of this subsection.

"(4) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

Information, availability.

"(5) In exercising its authority under this subsection, the Commission shall take such steps as it deems necessary or appropriate in the public interest or for the protection of investors (A) to achieve centralized reporting of information regarding ownership, (B) to avoid unnecessarily duplicative reporting by and minimize the compliance burden on persons required to report, and (C) to tabulate and promptly make available the information contained in any report filed pursuant to this subsection in a manner which will, in the view of the Commission, maximize the usefulness of the information to other Federal and State agencies and the public.

Exemption.

"(6) The Commission may, by rule or order, exempt, in whole or in part, any person or class of persons from any or all of the reporting requirements of this subsection as it deems necessary or appropriate in the public interest or for the protection of investors.

Report to Congress.

"(h) The Commission shall report to the Congress within thirty months of the date of enactment of this subsection with respect to (1) the effectiveness of the ownership reporting requirements contained in this title, and (2) the desirability and the feasibility of reducing or otherwise modifying the 5 per centum threshold used in subsections (d)(1) and (g)(1) of this section, giving appropriate consideration to—

Ante, p. 1498.

"(A) the incidence of avoidance of reporting by beneficial owners using multiple holders of record;

"(B) the cost of compliance to persons required to report;

"(C) the cost to issuers and others of processing and disseminating the reported information;

"(D) the effect of such action on the securities markets, including the system for the clearance and settlement of securities transactions;

"(E) the benefits to investors and to the public;

"(F) any bona fide interests of individuals in the privacy of their financial affairs;

"(G) the extent to which such reported information gives or would give any person an undue advantage in connection with activities subject to sections 13(d) and 14(d) of this title;

15 USC 78n.

"(H) the need for such information in connection with the administration and enforcement of this title; and

"(I) such other matters as the Commission may deem relevant, including the information obtained pursuant to section 13(f) of this title.".

"Held of record," definition.
15 USC 78o.

SEC. 204. Section 15(d) of the Securities Exchange Act of 1934 is amended by inserting immediately before the last sentence the following new sentence: "The Commission may, for the purpose of this subsection, define by rules and regulations the term 'held of record' as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions of this subsection.".

Approved December 19, 1977.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 95-640 accompanying H.R. 3815 (Comm. on Interstate and Foreign Commerce) and No. 95-831 (Comm. of Conference).
SENATE REPORT No. 95-114 (Comm. on Banking, Housing, and Urban Affairs).
CONGRESSIONAL RECORD, Vol. 123 (1977):
May. 5, considered and passed Senate.
Nov. 1, considered and passed House, amended, in lieu of H.R. 3815.
Dec. 6, Senate agreed to conference report.
Dec. 7, House agreed to conference report.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 13, No. 52:
Dec. 20, Presidential statement.

INTERNATIONAL DIVISION ACTIVITIES

International Economic Policy Section

The International Division staffs a system of committees, subcommittees, and task forces whose business members develop positions on international trade, investment and economic development issues for the National Chamber. These positions are the basis for congressional testimony and policy and program recommendations to the administration. Issues of current concern include: export controls; multilateral trade negotiations; boycotts; export financing; trade with socialist economies; trade in services; export promotion; codes of conduct; overseas business payments; transfer of technology; foreign investment taxation; energy and resource needs; and commodity agreements.

The International Economic Policy Section monitors and analyzes legislation affecting American business abroad, prepares testimony on the most significant bills before Congress and advises National Chamber members on crucial legislative developments. Close contacts are maintained with key congressional staff and executive branch officials on matters affecting international business.

In addition, the Section offers practical guidance and assistance to member firms, local chambers of commerce and other organizations in their efforts to expand international trade and investment and works to improve and expand national export promotion programs. It also works for more effective import adjustment mechanisms and promotes two-way investment.

International Economic Affairs Section

The International Division develops and conducts the foreign relations of the National Chamber. Through a process of business diplomacy involving business leaders in the United States and overseas, the Division develops recommendations on international economic problems to assure that government policy-makers in the United States and foreign countries are well advised of business attitudes. Also, it is responsible for the National Chamber's important working relationships with AmChams and for maintaining close contacts with foreign agencies involved in international economic matters.

The International Affairs Section's activities are divided into six regional areas:

African Affairs: Efforts are being made to facilitate American business relations with all countries of Africa. This program includes efforts to establish American chambers of commerce in key countries. AmCham Morocco has been operating since 1966, and AmCham South Africa was inaugurated in November 1977. A new bilateral council is being arranged with Nigeria. In addition, practical workshops and other initiatives for business development throughout the continent are emphasized.

Asian-Pacific Affairs: In addition to providing liaison for the 12 AmChams comprising the Asia-Pacific Council of American Chambers of Commerce (APCAC), the National Chamber provides the secretariat for the Advisory Council on Japan-U.S. Economic Relations. The Council is composed of chief executive officers of 60 major U.S. corporations who meet annually with their Japanese counterparts to propose solutions to problems within the Japan-U.S. economic and trade relationship. The National Chamber also staffs the India-U.S. Business Council, involving U.S. business leaders and their Indian counterparts in discussions on economic and commercial policies designed to strengthen the bilateral relationship, promote expanded trade and encourage U.S. investment in the Indian economy. A council linking the business communities of the United States and the five member nations of the Association of Southeast Asian Nations (ASEAN) - the Phillipines, Indonesia, Singapore, Malaysia, and Thailand - has been in operation since July 1979.

East-West Trade: The National Chamber provides staff support for U.S.-Eastern European economic councils with Romania, Hungary, Poland, Czechoslovakia and Bulgaria. These councils serve as recognized channels for communication between key U.S. business leaders and their East European counterparts. In an effort to expand trade and industrial cooperation, the councils closely examine legal and economic bottlenecks that hinder commercial interchange between the U.S. and selected Eastern European nonmarket economies. The National Chamber also holds a permanent seat on the board of directors of the U.S.-U.S.S.R. Trade and Economic Council - a business organization formed to facilitate U.S.-Soviet trade, and has a cooperative agreement with the U.S.S.R. Chamber of Commerce to encourage bilateral commercial relations.

European Affairs: The National Chamber maintains close liaison with 12 AmChams in the Western European and Mediterranean area and with their regional council, the Council of American Chambers of Commerce - Europe and Mediterranean (EuroMed) - communicating relevant trade and investment news to this region and tracking those aspects of Europe's political and economic evolution, inside the European Community (E.C.) and out, which may be significant for American business. The National Chamber staffs the E.C.-U.S. Businessmen's Council - a body of top American and Western European business leaders who deal on a continual basis with economic issues affecting the Atlantic Community and who advise their respective governments on how to deal with them. In addition, annual, formal conferences between private sector agricultural leaders from the European Community and the United States are organized by the National Chamber.

Hemispheric Affairs: The National Chamber staffs three important institutions which reflect the special geographic and historical ties between the United States and other Western Hemisphere nations. They are: the Association of American Chambers of Commerce in Latin America, (AACCLA) representing over 17,000 corporate and individual AmCham members in 15 Latin American countries, which has met biannually since 1933; and the Brazil-U.S. Business Council, established in 1976 as a channel of communication between business leaders of the two countries. AACCLA

the Canada-U.S. Committee and the Brazil-U.S. Business Council formulate recommendations on economic relations between these countries and the United States.

Middle East Affairs: Reflecting the rapidly growing importance of the countries of the Middle East to U.S. economic interests, and as part of the National Chamber's effort to address the energy and natural resource problems facing the business community and the trade, investment and monetary implications of these problems, the National Chamber staffs various activities involving the Middle East. In addition to monitoring developments in the area relevant to American business, advising members of emerging Middle East trade and investment opportunities, the U.S. Chamber administers five bilateral business councils with Egypt, Israel, Iran, Jordan and the Sudan. These councils involve prominent American business leaders with their counterparts in discussions of trade and economic policy issues to improve bilateral commercial relations and to expand mutually beneficial flows of trade and investment.

INTERNATIONAL RESEARCH AND SPECIAL PROJECTS SECTION

The International Research and Special Projects Section is responsible for the study, analysis and preparation of research reports and issue papers that are used for policy development and implementation by the Division's International Economic Policy and International Economic Affairs Sections. In addition, this Section's monitors legislative developments and activities of intergovernmental organizations that have an international economic impact on the U.S. business community.

A variety of reports, surveys and other publications are produced by this Section to educate and mobilize the public on important international commercial and economic questions, including the monthly "International Report" and the "Trade Policy Review".

This Section organizes conferences, seminars and symposia to publicize topical trade and investment issues and to help frame solutions to related international economic questions. Also, it provides sources of information for certain business and cultural inquiries on the international level, including importing and exporting, employment overseas and technical associations.

CALIFORNIA STATE
WORLD TRADE COMMISSION

GEORGE DEUKMEJIAN
Governor

LEO T. McCARTHY
Lt. Governor

FRED W. ANDREW
Superior Farming Company

THOMAS L. BERKLEY
Berkley, Rhodes & Schwartz

LILY CHEN
Monterey Park City Council

EDWARD N. GLAD
Glad & Ferguson

C. ROBERT LANGOLET
Port of Long Beach

JOHN R. LIEBMAN
Rosenman, Gutherz, Rhoe & Elliott

FRANK R. LIGHT
Sun Diamond Growers of California

JAMES D. LUTTON
Solar Turbines Inc

E. A. MELENDEZ
Atlantic Richfield Co

ROBERT T. MONAGAN
California Economic Development Corporation

CHARLES H. NEVIL
The Meridian Group

WALTER F. PAYNE
California Almond Growers Exchange

GREGORY MIGNANO
Executive Director

MARCH FONG EU, Chair
Secretary of State

June 9, 1986

The Honorable John Heinz, Chairman
Senate Subcommittee on International
Finance And Monetary Affairs
SR-277 Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

RE: Foreign Corrupt Practices Act Reform

In view of the upcoming joint hearing of the Senate Subcommittee on International Finance and Monetary Policy and the Subcommittee on Securities, the California State World Trade Commission would like to reiterate its concerns about the Foreign Corrupt Practices Act (FCPA).

The California State World Trade Commission is committed to enhancing the international competitiveness of our industries and to developing an effective partnership between government and business. The Commission includes the Governor, Lt. Governor and Secretary of State, as well as twelve private sector members. The Commission is assisted by an Advisory Council which includes representatives from the legislative and executive branches of government and leaders from a variety of industries including manufacturing, agriculture, services and transportation. Thus, resources of both the public and private sectors have been mobilized to advance California's international economic objectives.

One of these objectives relates to the clarification of the Foreign Corruption Practices Act. In January of 1984, the Commission went on record favoring the amendment of the FCPA. Since that time, it has repeatedly heard both formal and informal testimony from California exporters about the negative impact of the law on our ability to compete overseas.

1121 L Street, Suite 310 Sacramento, CA 95814 (916) 324-5511 Telex: 5106003794

The California State World Trade Commission supports the objective of the Foreign Corrupt Practices Act of 1977 to eliminate bribery and extortion in international business. It is concerned, however, that the vague and ambiguous statutory language has impaired the export performance of California companies by causing them to lose or forego legitimate business opportunities rather than risk FCPA consequences. The California State World Trade Commission favors amending the FCPA to:

1. Clarify the responsibility for acts of third parties and the "reason to know" standard of liability.

2. Provide a clearer definition of permissive or facilitating payments, based on the purpose of the payment rather than the position of its recipient.

3. Revise and simplify the FCPA accounting and recordkeeping requirements.

4. Provide for uniformity of jurisdiction over enforcement of anti-bribery provisions.

5. Mandate multilateral negotiations for an international agreement against bribery.

We recognize that this issue is not without controversy, and appreciate your leadership in addressing this significant obstacle to our international competitiveness.

Sincerely,

Isabella D. Kaliszczak

Isabella D. Kaliszczak
Washington Counsel

IDK/adt

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July 15, 1986

The Honorable John Heinz
United States Senate
Washington, D.C. 20510

Dear Senator Heinz:

Enclosed please find a statement from the Asia-Pacific Council of American Chambers of Commerce (APCAC) in support of S. 430.

The APCAC representatives who were in Washington last month very much valued the time you spent with them over lunch. They especially welcomed your interest in hearing about the impact of the Foreign Corrupt Practices Act.

In response to your request for more information, they have asked me to convey the attached statement. If possible, APCAC would appreciate having their remarks entered into the record of the hearing your subcommittee held June 10.

On their behalf, I would like to express our thanks for your meeting the group last month. As their award to you emphasized, APCAC appreciates your leadership on FCPA reform, export financing and other international issues crucial to U.S. commercial success in Asia.

Should you or your staff have any questions regarding the attached APCAC statement, pelase contact me.

Thank you for your interest and attention to this APCAC initiative.

Sincerely,

M. V. Fleet

Mark Van Fleet
Director, Asia-Pacific Affairs

Enclosure
cc: John Walsh

STATEMENT BY JAMES R. KLEIN, CHAIRMAN OF THE ASIA PACIFIC COUNCIL OF AMERICAN CHAMBERS OF COMMERCE, IN SUPPORT OF S.430, "THE BUSINESS ACCOUNTING AND FOREIGN TRADE SIMPLIFICATION ACT"

S.430 is designed to amend the Foreign Corrupt Practices Act ("FCPA") to make the FCPA a precise, enforceable criminal statute. Overwhelming testimony and evidence from the business, legal, accounting and law enforcement communities indicate that the FCPA is overbroad, confusing and vague.

Law abiding United States companies are entitled to a clear, specific law so that they can conduct business in an honest manner without fear of criminal prosecution. APCAC strongly supports the passage of S.430 and submits that clarification of the FCPA will encourage small and medium sized United States companies to expand their businesses by exporting.

The Foreign Corrupt Practices Act

The FCPA was signed into law on December 19, 1977. The FCPA was passed unanimously by Congress following widespread reports of questionable payments in connection with United States business activities both at home and abroad.

The FCPA was designed to eliminate currupt practices which Congress found to be destabilizing and detrimental to the long term interests of American business and United States foreign relations. Bribery was considered by Congress to be inconsistent with the basic underlying principle of the free enterprise system that business should compete on the basis of superior performance and not by corruption.

The FCPA makes certain payments, offers of payment and gifts to foreign officials, political parties or political candidates illegal. The FCPA also establishes recordkeeping requirements for all publicly held corporations whether or not the corporation is engaged in international business.

1. The Anti-bribery Provisions

The FCPA makes it a criminal offense for any officer, director, employee, agent or stockholder to make certain types of payments, directly or indirectly, to foreign government officials and/or to foreign political parties.

Issuers of securities, as defined in §.12 of the Securities Exchange Act of 1934 (the "Act"), companies that are required to file reports under §15 of the Act and domestic concerns are prohibited from using the mails "or any means or instrumentality of interstate commerce corruptly in furtherance of any offer, payment, promise to pay, or authorization of the payment of any

money, or offer, gift, promise to give or authorization of the giving of anything of value" to any foreign government official for the purpose of obtaining or retaining business for the payor or any other person.

This business purpose is a necessary element of any offense under the FCPA. The direct recipient of the payment need not be a foreign government official. Payments to intermediaries, e.g., commercial agents, are prohibited if the payor knows or has reason to know that the payment will be forwarded to a foreign government official. Payments to officers, employees and agents of commercial enterprises that are owned by foreign governments may also be covered by the FCPA.

a. Facilitating Payments

The American business community is concerned about the difference between a legal "payment" and an illegal "bribe" under the FCPA. Facilitating payments ("grease" payments), such as gratuities to encourage low level bureaucrats to perform their duties of processing forms, approving licenses or unloading perishable goods, were not intended to be covered by the anti-bribery provisions. The FCPA expressly excludes foreign government employees whose duties are essentially ministerial or clerical from the definition of "foreign officials" to whom payment is prohibited.

The legislative history of the FCPA indicates that Congress' use of the term "corruptly" in defining the foreign bribery offense is meant to exclude payments to secure, or to secure more quickly, the performance of ministerial duties. The line between ministerial and discretionary functions is not clear. An American doing business in a foreign country is not in a position to determine what acts a government employee is required or even authorized to perform. Consider the following situations.*

(1) The local director of an American company in a foreign country paid a customs official $20 to process spare parts release forms. The official suggested that the alternative would have been to wait several days for "further formalities". The local director was reimbursed by his managing local director in the United States, but the payment did not pass the internal auditor from the home office because of uncertainty over what constitutes a facilitating

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* All examples of American companies' difficulties with application of the FCPA are extracted from documents submitted by the United States Trade Representative during the "FCPA-Oversight Hearings before the Subocmmittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce (the "Committee") of the House of Representatives," 97th Cong., 260-264 (1981) (Statement of William E. Brock, U.S. Trade Representative, Executive Office of the President).

payment. The parent company spent $30,000 internally investigating why the $20 payment was made and how to cope with it under the FCPA. According to the FCPA's legislative history, this was a legal payment.

(2) During a trip to Singapore, a United States company learned that a series of payments would be required in order to do business in Indonesia. These included payments to the switchboard operator in the hotel, to secretaries for arranging appointments, to the administrative assistant of the customer to meet with the customer, to all company sales representatives, to guards watching unloaded merchandise and to customs officials. Uncertain as to which payments were prohibited by the FCPA, the company elected not to compete for a contract.

b. Commercial Agents

A company's liability for the actions of its foreign agents creates many problems for United States companies engaged in international business transactions. It is particularly difficult for a United States company, large or small, to protect itself against the misbehavior of one of its agents in a foreign nation. Large corporations use hundreds of sales agents throughout the world. Small companies, often attempting to export for the first time, must rely upon individuals about whom only limited information is available.

2. The Accounting Provisions

The FCPA includes accounting provisions which prescribe the form in which required information is to be set forth. The accounting provisions were designed to prevent corporate management from setting up slush funds and maintaining duplicate sets of books and offshore accounts to accumulate funds for bribery of foreign and domestic officials.

The accounting provisions of the FCPA stem from disclosures in 1973 that corporate funds had been used for illegal domestic political contributions. Subsequent investigations by the Securities and Exchange Commission ("the SEC") revealed instances in which questionable or illegal payments, both foreign and domestic, had not been disclosed to the investing public.

Under the accounting provisions, a corporation is potentially liable for the smallest accounting error, and whether the error is material, intentional or related to a corrupt payment is irrelevant. A company need not be engaged in corruption or foreign sales to violate the FCPA. It is a violation for a company not to keep its company books in the detail which the SEC deems necessary.

The accounting provisions of the FCPA require issuers of securities (a) to make and keep books, records and accounts, which

in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuers and (b) to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that certain statutory objectives are met. These provisions require companies to determine the degree of detail necessary for "accurate and fair" recordkeeping and internal controls.

Business managers assert that the "reasonable assurances" test is vague. They do not know what the SEC considers "reasonable." Consequently, companies tend to be extremely conservative when interpreting reasonableness. The cost of an internal accounting system implemented to meet the "reasonable assurances" test in some cases has cost companies tens of thousands of dollars.

Conclusion

The FCPA prohibits companies, their officers, directors, employees and agents from corruptly making payments to foreign government officials. A number of United States firms have been very concerned about the possibility of imputed liability under the FCPA, based on the unethical conduct by a foreign commercial agent where the United States firm may be deemed to have reason to know of its agent's conduct.

A United States businessman cannot predict what circumstances may someday be considered to be sufficient evidence that he had reason to know of possible wrongdoing. This unreasonable burden on United States firms makes certainty of compliance with the FCPA virtually impossible. Rather than risk violating the FCPA, many United States companies prefer to avoid certain markets or to forego legitimate business transactions. Consider the following incidents:

(1) The United States Embassy in Muscat, Oman reported that a United States firm lost a $20-$30 million contract solely because of the time delays needed to investigate sales agents and assess the firm's responsibility for third parties under the FCPA.

(2) A multinational United States-based engineering company spent approximately $250,000 to evaluate its potential market in Latin America. Brazil, Mexico and Venezuela were considered open markets for exporting engineering services and establishing local service branches. One of the major reasons the company chose not to expand was its uncertain liability under the FCPA for the activities of independent agents and subcontractors. Moreover, the cost of policing such activities would have significantly reduced its ability to compete.

c. Token Gifts

Treatment under the FCPA of a wide variety of gifts and payments, such as political contributions, courtesy gifts, tokens of esteem and travel and lodging provided to foreign officials in connection with attendance at business presentations, has caused uncertainty and anxiety to members of the United States business community. This uncertainty creates a chilling effect for United States firms attempting to sell overseas.

When faced with the decision whether to make a particular payment in a foreign country, United States companies either elect to forfeit the business opportunity or alienate foreign businessmen by refusing to make payments or gifts which may result in liability under the FCPA. Consider the following case:

> An American steel company, which was negotiating a cooperative venture with a Chinese organization, refused to pay for the travel expenses in the United States during a planned trip by Chinese executives to inspect the American company's facilities. Offended by the American company's refusal to pay because of possible liability under the FCPA, the Chinese executives never visited the United States and terminated contract negotiations.

A person who is convicted of violating the FCPA under the reason to know test is exposed to up to 5 years imprisonment. By contrast, a person who engages in conduct that he has reason to know will result in bribery of a domestic official does not commit any crime. (18 USC S201(b)). Are slight degrees of corruption by foreign agents sufficiently reprehensible to justify imposition of the serious criminal penalties of the FCPA?

Many of the problems businessmen face with the FCPA occur in developing countries, where normal business practices vary from United States business practices. There is also more direct government involvement in the day-to-day operations of the economy and foreign officials frequently are engaged in business transactions.

Since 1970, the United States' share of trade with developing countries has steadily declined. United States companies are reluctant to enter some markets because the social and business customs in some countries are markedly different from United States business customs. The ambiguous provisions of the FCPA deter United States businessmen from entering these markets because they fear that necessary payments associated with doing business in some markets may violate the FCPA. The FCPA has acquired a reputation as one of the United States' most serious export disincentives.

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June 27, 1986

The Honorable John H. Heinz, III
Chairman
Subcommittee on International
Finance and Monetary Policy
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Heinz:

Attached is a written statement by the Committee on Government Liaison of the Financial Executives Institute. We would like to submit this statement as part of the hearing record of June 10th concerning S.430, the Business Accounting and Trade Simplification Act.

The Institute has consistently endorsed reform of the accounting provisions of the FCPA and welcomes the opportunity to express our views in that regard. If you or any member of the Committee staff should have a question regarding our written submission, please do not hesitate to contact our Washington office.

Sincerely,

Bob Amick

Robert O. Amick
Chairman

The Financial Executives Institute (FEI) appreciates the opportunity to make a written submission as part of the hearing record concerning S.430, the Business Accounting and Foreign Trade Simplification Act. The FEI previously supported two predecessor bills which proposed similar amendments to the Foreign Corrupt Practices Act of 1977 (FCPA).

As you are no doubt aware, the Financial Executives Institute is a professional business organization of individual members who are senior financial and administrative officers in business organizations throughout the United States. FEI has over 13,000 members who are affiliated with some 6,000 companies in virtually all segments of the economy and who, therefore, represent a broad cross-section of American business. The Committee on Government Liaison, one of the technical committees of the Institute, is authorized to formulate statements and positions on federal legislative, and regulatory proposals that are clearly relevant to the responsibilities and interests of the financial executive. The Committee's members are the corporate officers who are responsible for, among other things, the design and implementation of their companies' internal accounting control systems and thus are uniquely qualified in terms of expertise and experience to comment on the requirements of the accounting provisions of the FCPA.

We are encouraged by the Subcommittees' decision to hold this joint hearing because we believe S.430 is a reasonable and welcome response to the present inappropriate, vague, and impracticable accounting provisions of the FCPA.

FEI strongly believes that improvements in the section 102 requirements are necessary. We believe this initiative will benefit U.S. business and the economy, and that such improvements will not compromise the central purpose of the Foreign Corrupt Practices Act.

The Securities and Exchange Commission (SEC) has noted in prior testimony the "degree of consternation" that the FCPA has generated "among businessmen of utmost good faith." Many businessmen have expressed the concern that the accounting provisions of the Act expose them to criminal liability or SEC enforcement action because of insignificant errors or weaknesses in corporate records or internal accounting controls. The SEC has noted the anxiety created by these accounting provisions and has issued a policy statement which recognizes the debilitating effects of the uncertainties resulting therefrom.

Because of the uncertainty of application of the law and the desire to avoid violation of it, many companies are striving to comply with impracticable requirements which we believe result from serious deficiencies in the existing law. Such deficiencies include the lack of any distinction between a mistake in accounting and an intentional act, and the perceived wide-ranging application of the law to any and every record-keeping and internal accounting control deficiency, without regard to whether anyone would think the deficiency to be significant.

FEI has previously testified that in our opinion, a preferable solution and the most realistic way to reduce the burden on American business and still reinforce the prohibition against foreign bribery would be to replace section 102 of the Act with a direct prohibition against falsifying or intentionally altering company books and records for the purpose of concealing an illegal act, as defined in the anti-bribery provisions of the law.

As financial officers, we believe this approach would be a far more effective way to accomplish what we believe was the central purpose of section 102--to reinforce the anti-bribery provisions of the FCPA. In our view, the clarity of this approach would provide an evenhanded application of this regulatory overlay to U.S. companies engaging in the conduct of foreign business and would eliminate the discrimination which exists under the current law--which applies only to certain companies subject to SEC reporting requirements.

We believe this approach is far more realistic in terms of the explicit recognition that no system of internal accounting control, no matter how great the resources applied, will prevent improprieties and/or deviant conduct, such as foreign bribery.

There are those who express concerns that any clarification or improvement of these accounting provisions will undermine the enforcement efforts of the SEC. While the Commission has brought 73 actions to enforce the accounting provisions of the FCPA since 1977, the violations of the accounting provisions have been uncovered in conjunction with investigations into potential violations of other sections of the securities laws. In all but three of these cases, action could have been brought and sustained without recourse to the accounting provisions of the FCPA.

One of our key concerns is that the accounting provisions, as presently stated, place an excessive burden on all publicly owned American companies that must file reports with the SEC, including small domestic firms with no foreign sales or export business. These provisions are not limited to illegal acts as defined in the anti-bribery provisions of the 1977 law. They also extend far beyond illicit payment practices. We are concerned that these provisions may extend to errors which can and do occur in an accounting system without any intention to commit or conceal an illegal act.

Moreover, because of the vagueness of the statutory language and the uncertainties, such as the lack of a realistic threshold, these accounting provisions have diverted substantial resources from productive endeavors into defensive expenditures and costs which have little, if any, justification beyond the attempt to develop documentation and other "evidence" that the company is trying to comply with the Act.

The appropriate solution to the aforementioned problems would be to replace section 102 with a direct prohibition against falsifying or intentionally altering company books and records for the purpose of concealing an illegal Act. In the event that this proposal is not acceptable, we fully endorse and support S 430 as a reasonable means for clarifying the law without jeopardizing the objectives of the FCPA.

We thank you for the opportunity to make this submission to the hearing record and are prepared to answer any questions that the Subcommittees may wish to direct to us.